



LGIP QUARTERLY MEETING & CONFERENCE CALL

4.26.2012

OFFICE OF THE ARIZONA STATE TREASURER



AGENDA

- **LGIP Performance**
- **LGIP Legal Updates**
- **Endowment Performance**
- **Asset Allocation Study**
- **Endowment Distribution Formula**
- **State Cash Flow**
- **State Budget Presentation: Richard Stavneak, Director
Joint Legislative Budget Committee**
- **Q & A**



INVESTMENT PHILOSOPHY

SAFETY

before

LIQUIDITY

before

YIELD



EARNINGS FOR FY 2012 YTD

\$98,263,702





LGIP PERFORMANCE

Q3 FY2012



POOL 5

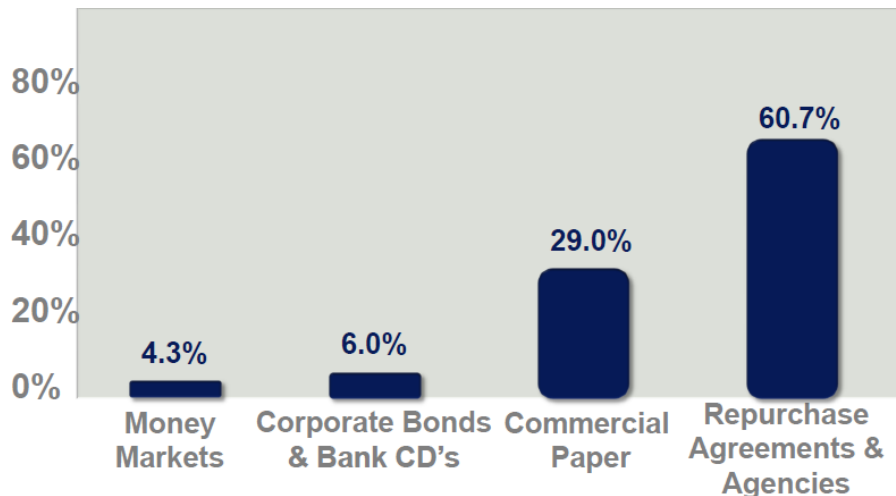
- \$1.47 Billion Assets as of 3/31/2012
- Net Asset Value - \$1.000 3/31/2012
- Diversified investments weighted to highly rated Commercial Paper first, Repurchase agreements second, and Agency/Treasuries third

Liquidity

Weighted Average Maturity: 19 days on 3/31/2012

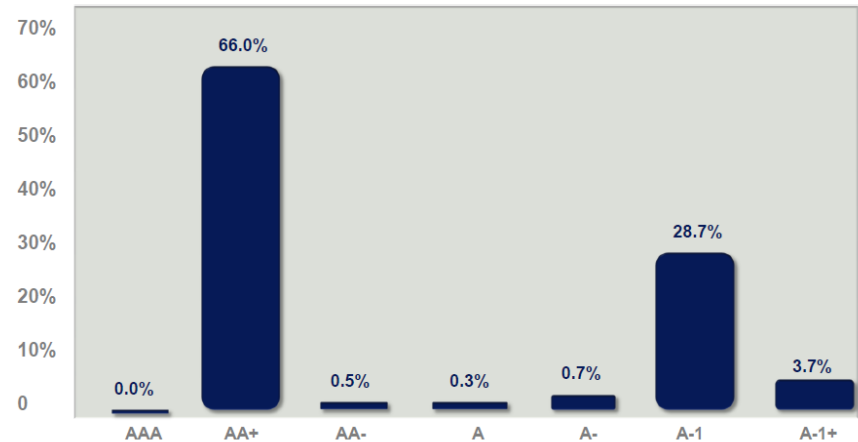
DURATION: 100% from 0-1 yrs

ASSET MIX:



Safety

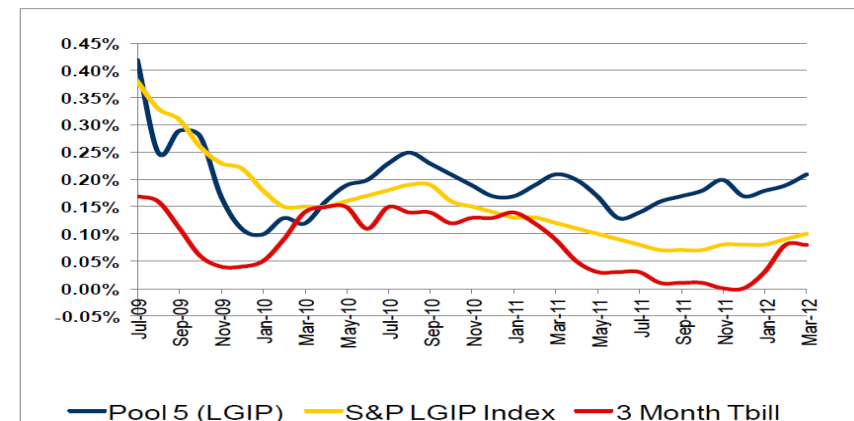
Continues to receive highest rating from Standard & Poor's: AAAf/S1+



Yield

.18% FYTD

.08% FYTD (S&P LGIP Index)



POOL 7

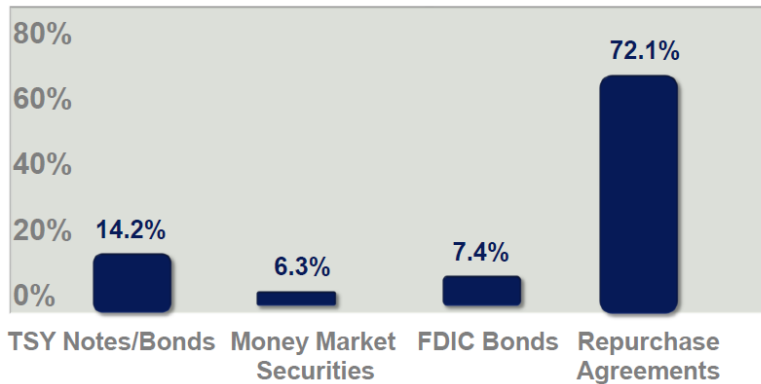
- \$1.6 Billion Assets as of 3/31/2012
- Net Asset Value - \$ 1.000 3/31/2012
- Repo market eased in the most recent quarter. Shifting back to more overnight repo combined with a constant stream of maturing securities and laddering out repo purchases along a three to five week time span

Liquidity

Weighted Average Maturity: 22 days on 3/31/2012

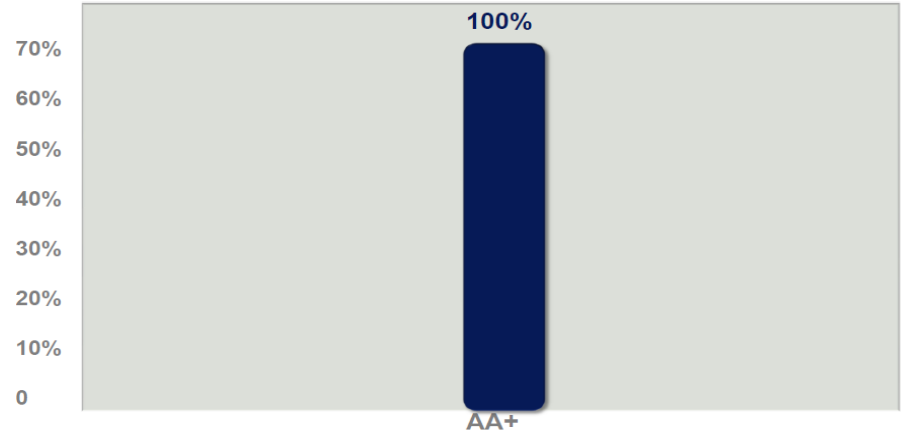
DURATION: 100% from 0-1 yrs

ASSET MIX:



Safety

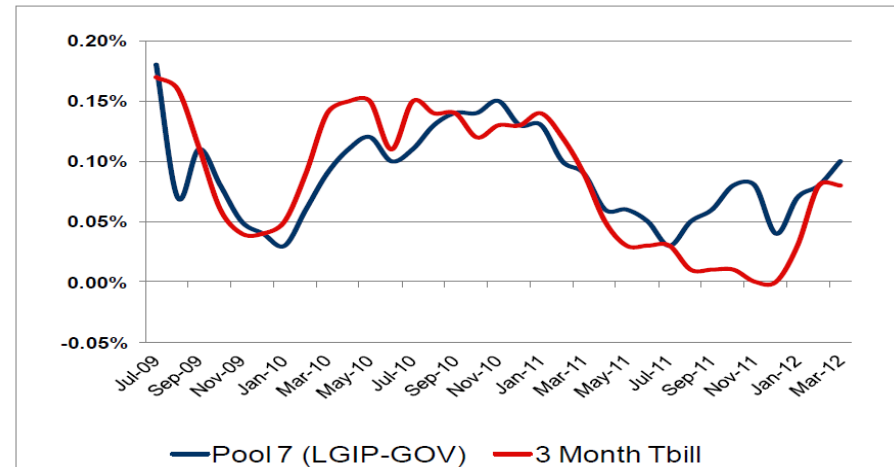
AA+ Weighted Average Rating



Yield

.07% YTD

.03% YTD (90 DAY T BILL)



POOL 500

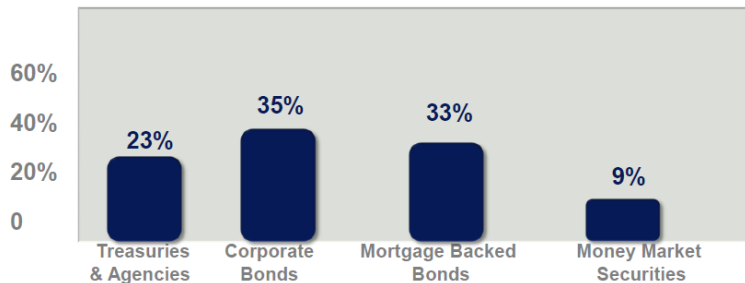
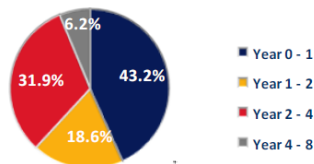
- \$227.8 million in assets as of 3/31/2012
- Floating Net Asset Value - \$1.0395 3/31/2012
- Will continue to invest in assets that provide a prudent diversification that takes advantage of prevailing market opportunities
- Keep maximum exposure to any credit at 2.5%

Liquidity

Effective Duration: 1.58 years on 3/31/2012

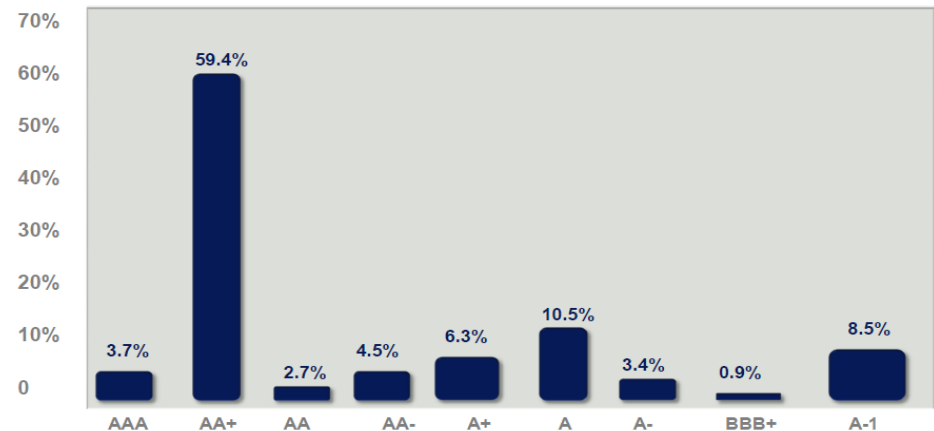
DURATION:

ASSET MIX:



Safety

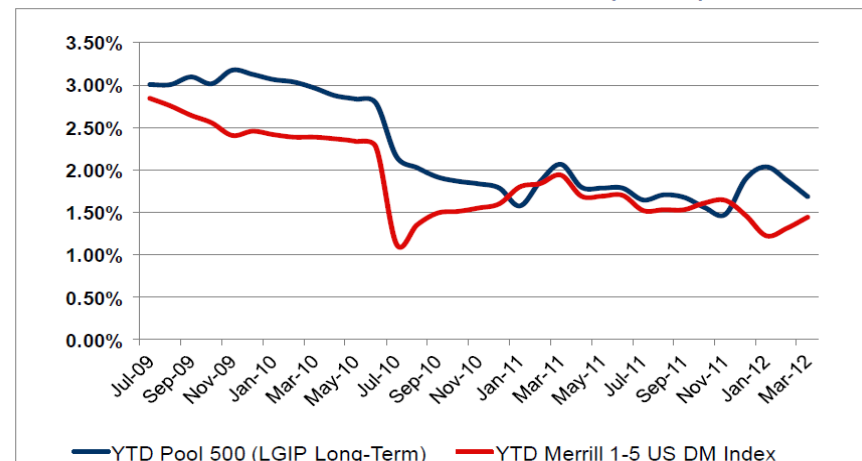
AA Weighted Average Rating



Yield

1.74% YTD

1.47% YTD (Index)



POOL 700

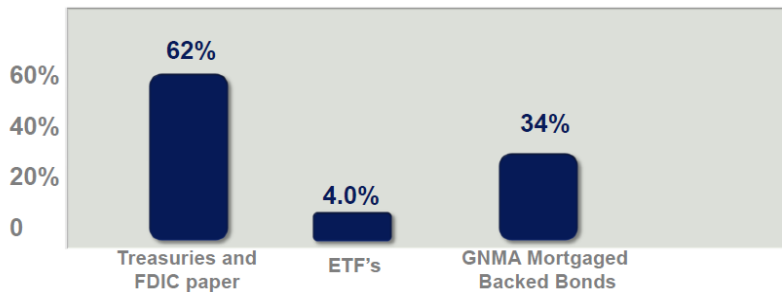
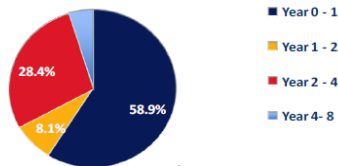
- \$158.9 million in assets as of 3/31/2012
- Floating Net Asset Value - \$ 1.011 3/31/2012
- Strategy is to invest in a mix of 1-5 year US Treasuries, GNMA Mortgages and FDIC Paper
- All securities backed by US Government

Liquidity

Effective Duration: 1.34 years on 3/31/2012

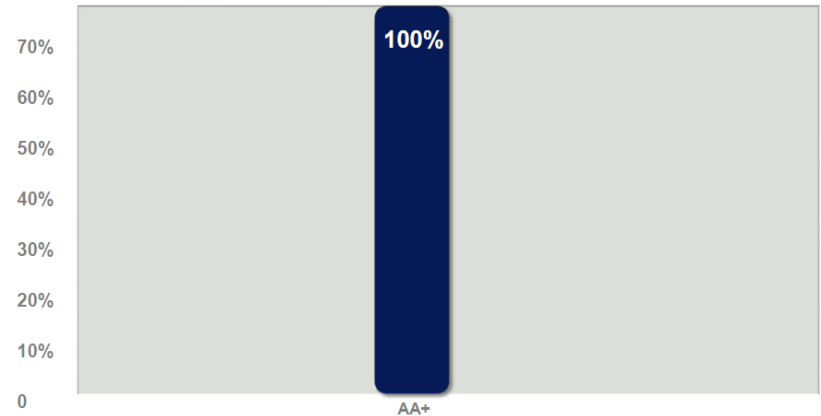
DURATION:

ASSET MIX:



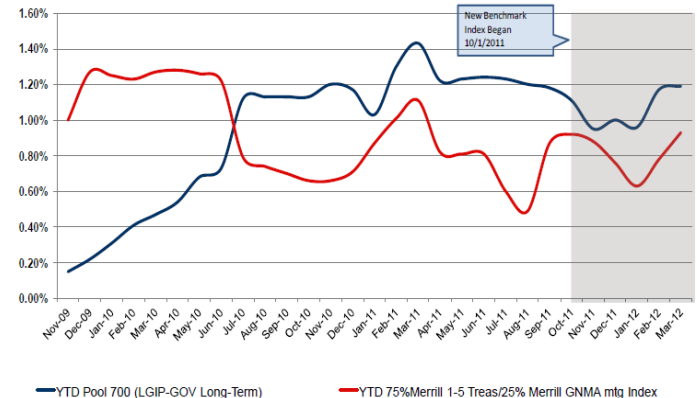
Safety

AA+ Weighted Average Rating



Yield

1.11% YTD 0.87% YTD (Index)



LEGAL UPDATES

- **NCFE:**
Status on Litigation
- **Lehman:**
Status on Distributions





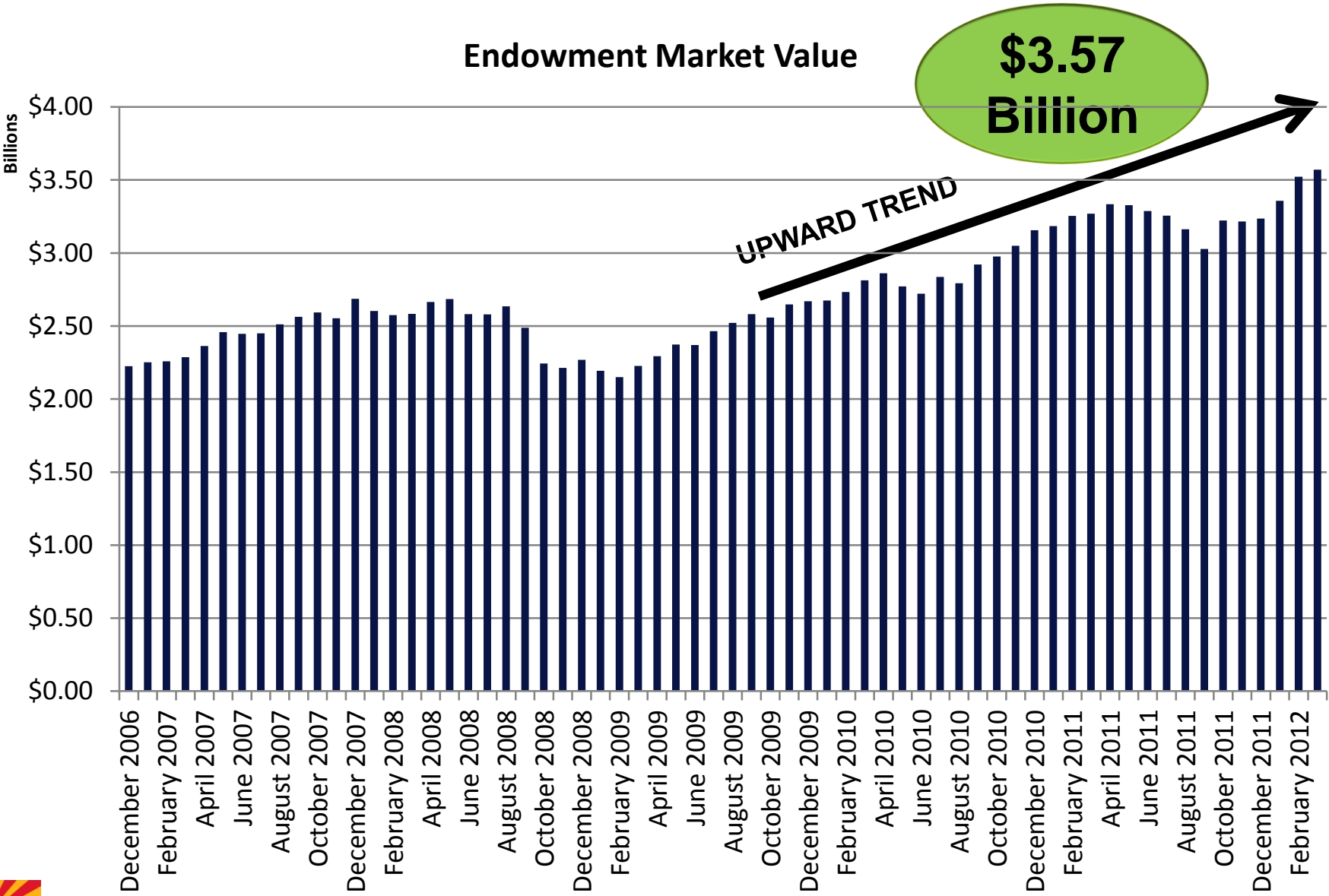
ENDOWMENT PERFORMANCE

Q3 FY2012

OFFICE OF THE ARIZONA STATE TREASURER



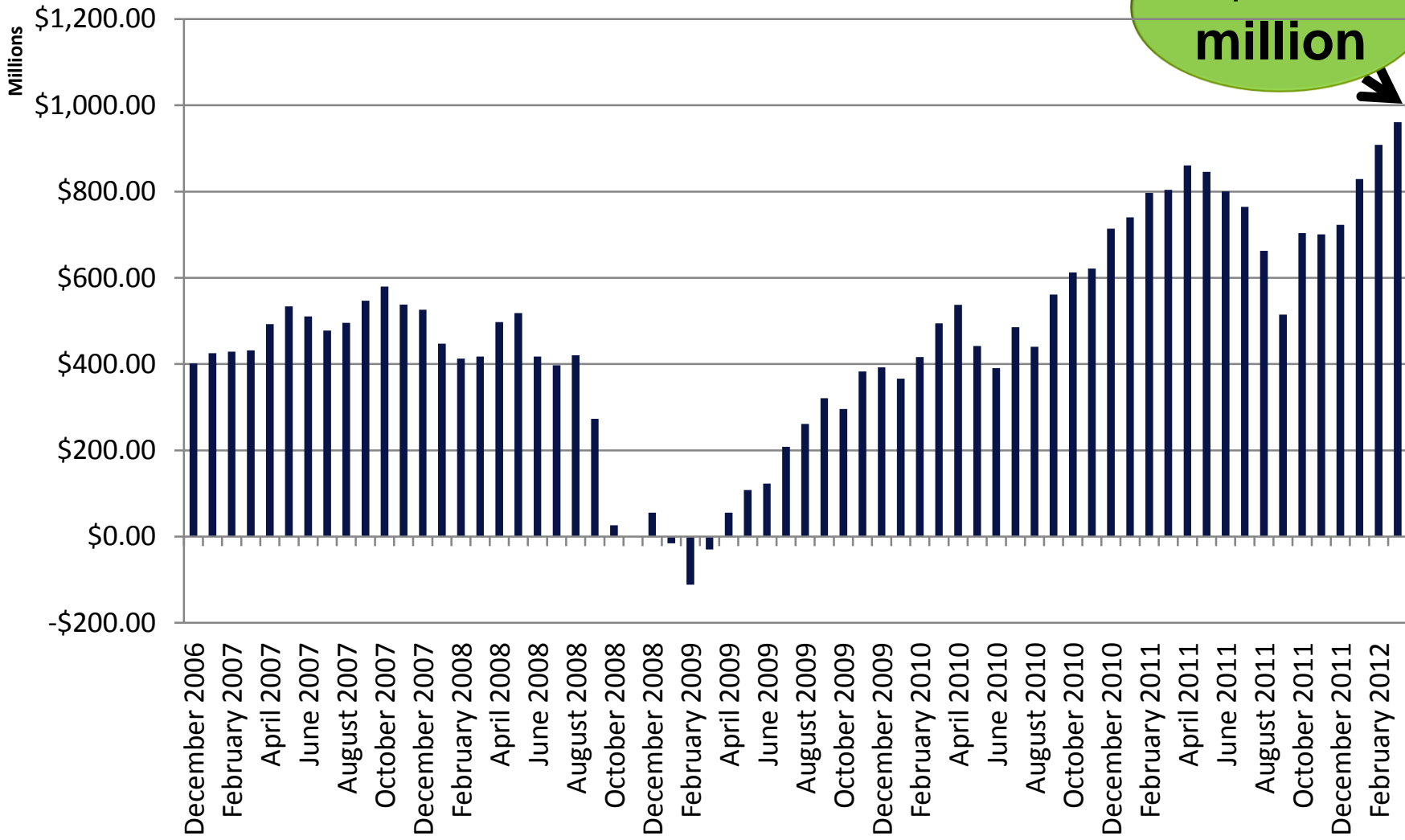
ENDOWMENT MARKET VALUE



ENDOWMENT UNREALIZED GAINS

Total Endowment Unrealized gains/losses

**\$960
million**



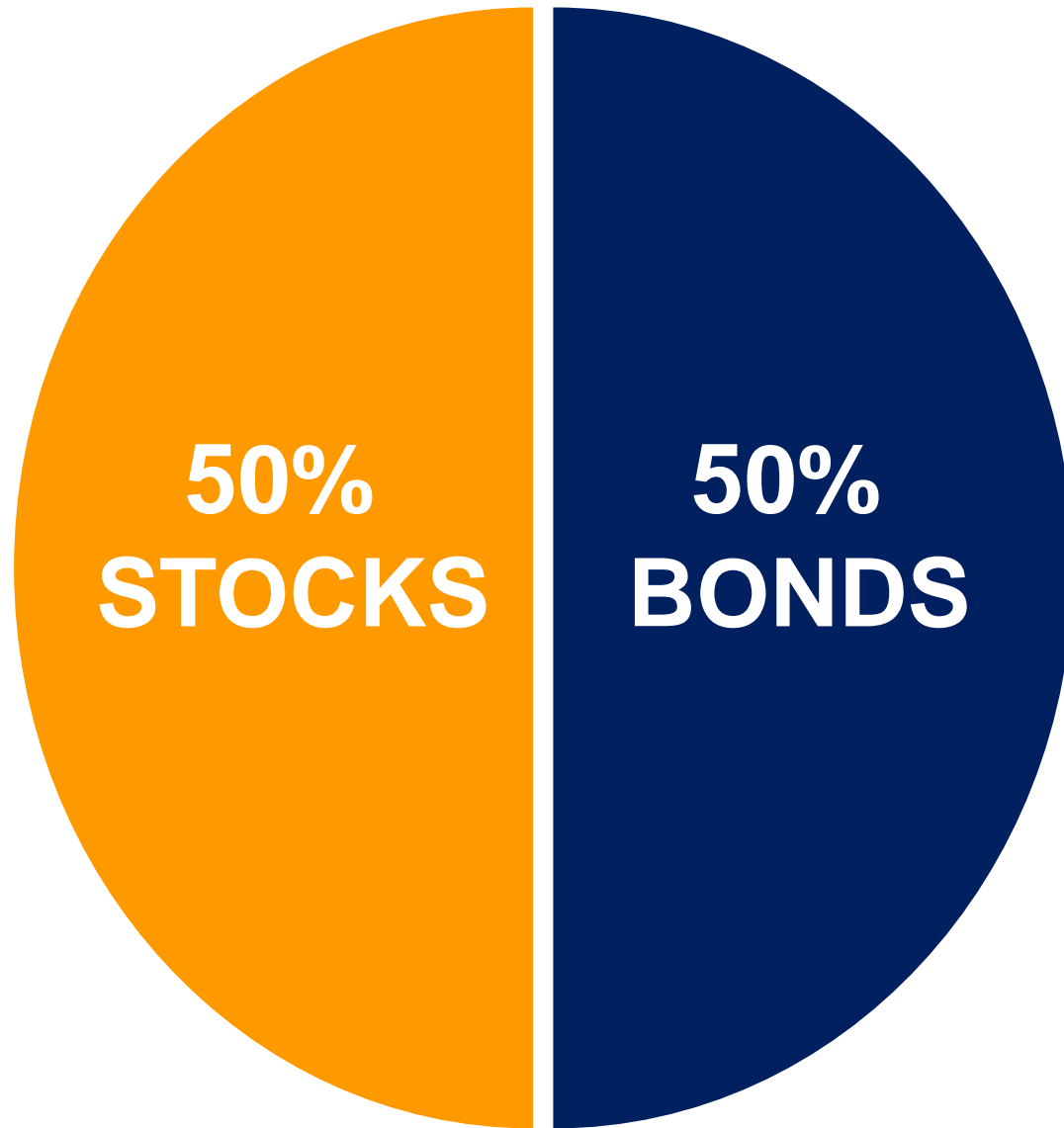


ASSET ALLOCATION STUDY

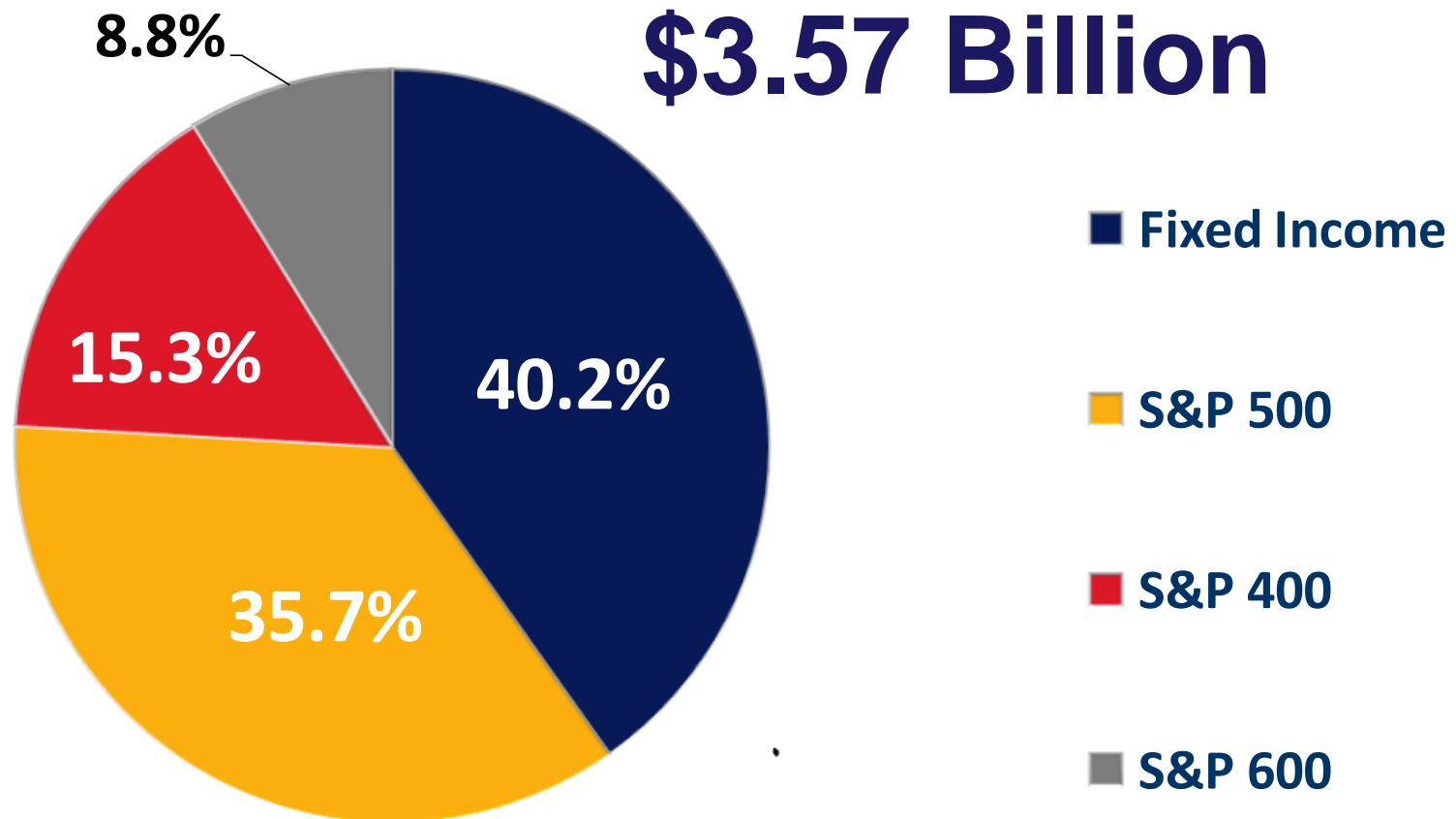
OFFICE OF THE ARIZONA STATE TREASURER



ASSET ALLOCATION: MARCH 2003 - FEB 2011



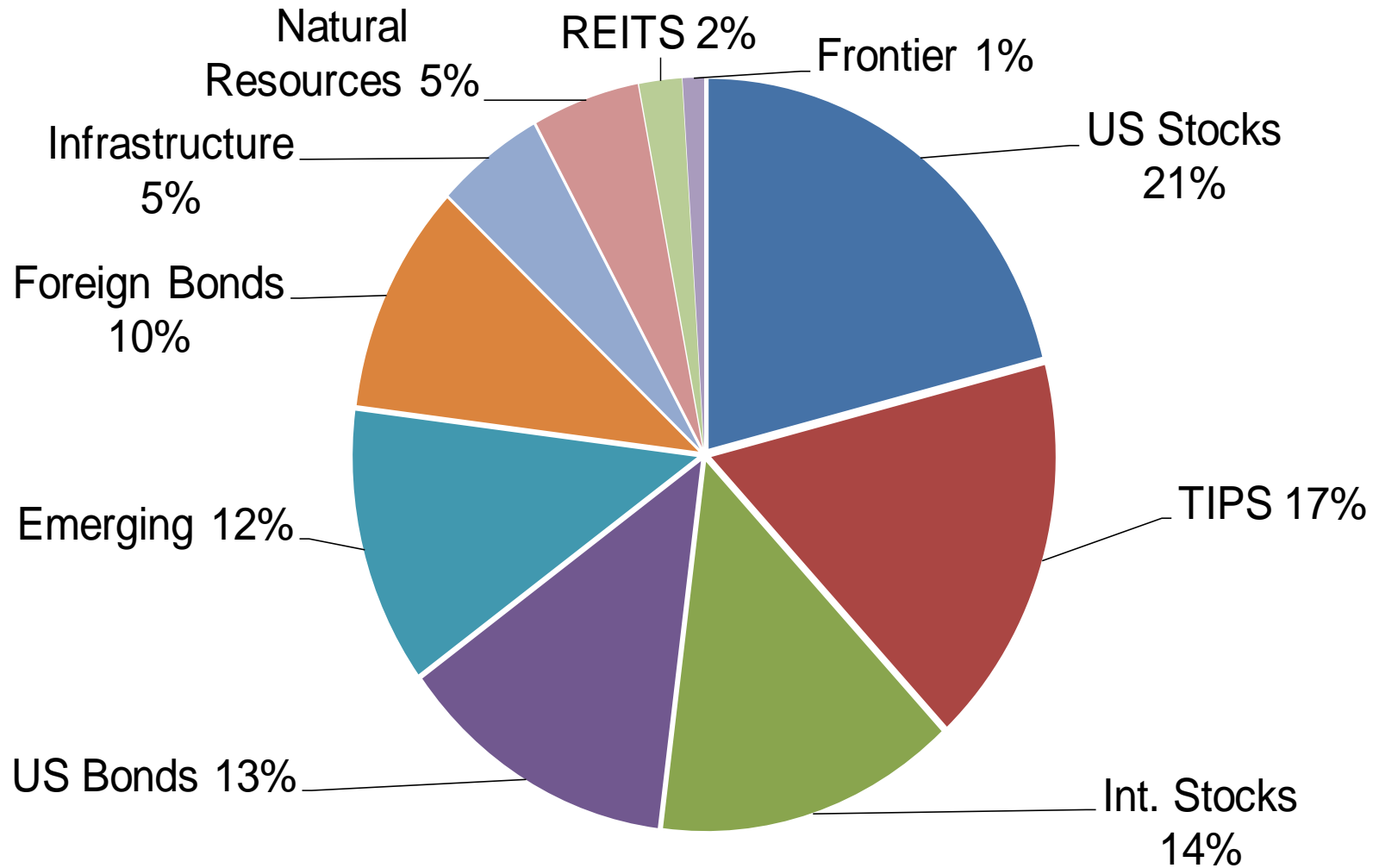
ENDOWMENT ASSET ALLOCATION



As of 3/31/2012



TARGET ASSET ALLOCATION



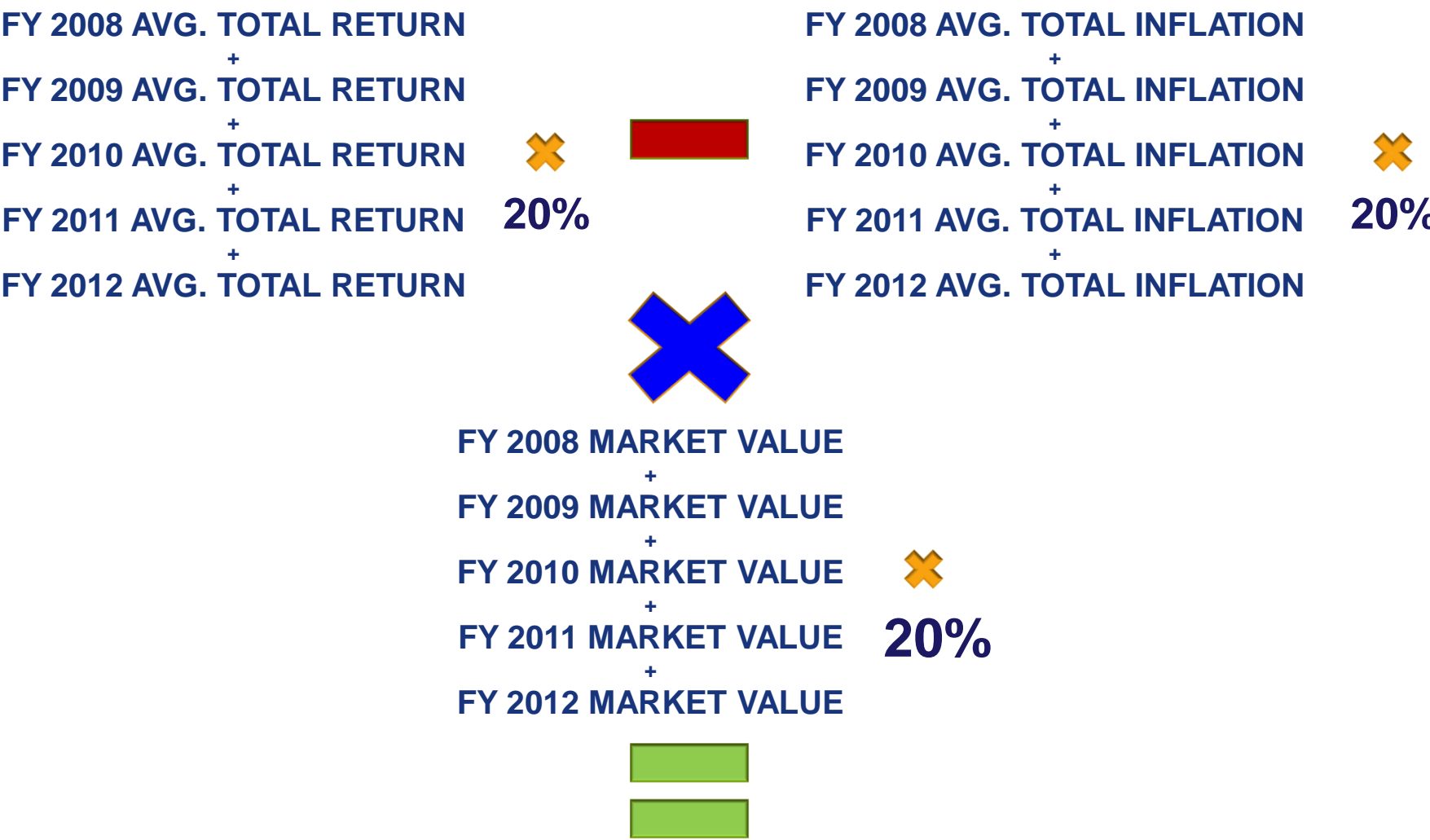


ENDOWMENT DISTRIBUTION FORMULA

OFFICE OF THE ARIZONA STATE TREASURER



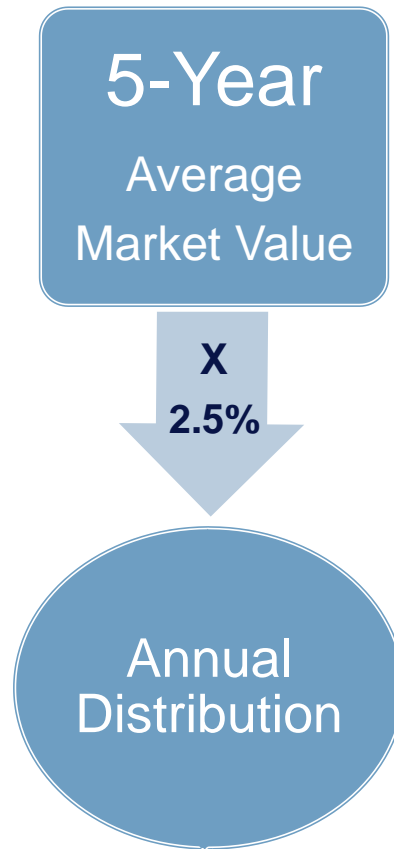
CURRENT DISTRIBUTION FORMULA



ANNUAL DISTRIBUTION



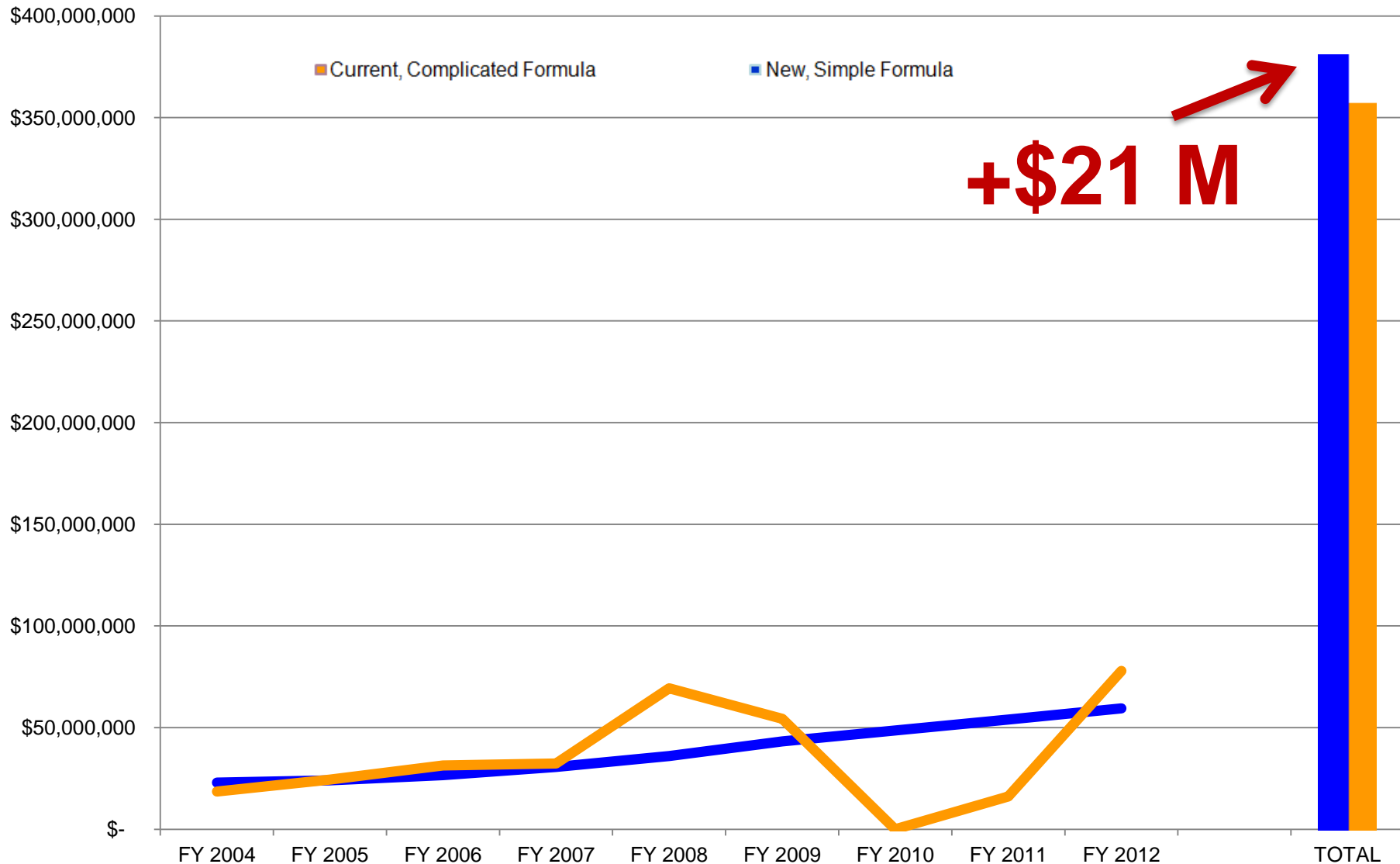
SMOOTHER, CONSISTENT DISTRIBUTIONS



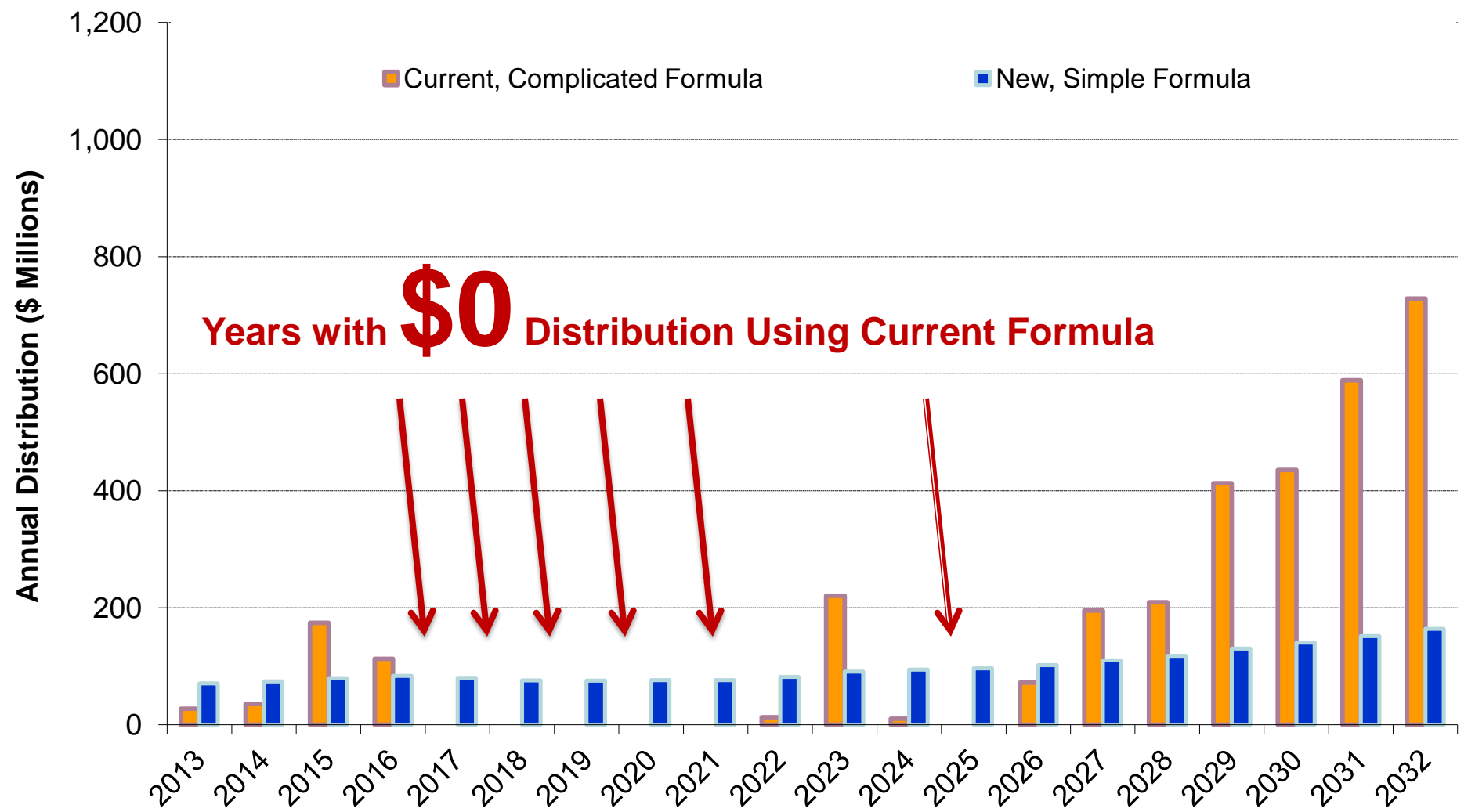
Takes 2.5% of the average monthly market value from each of the previous five years



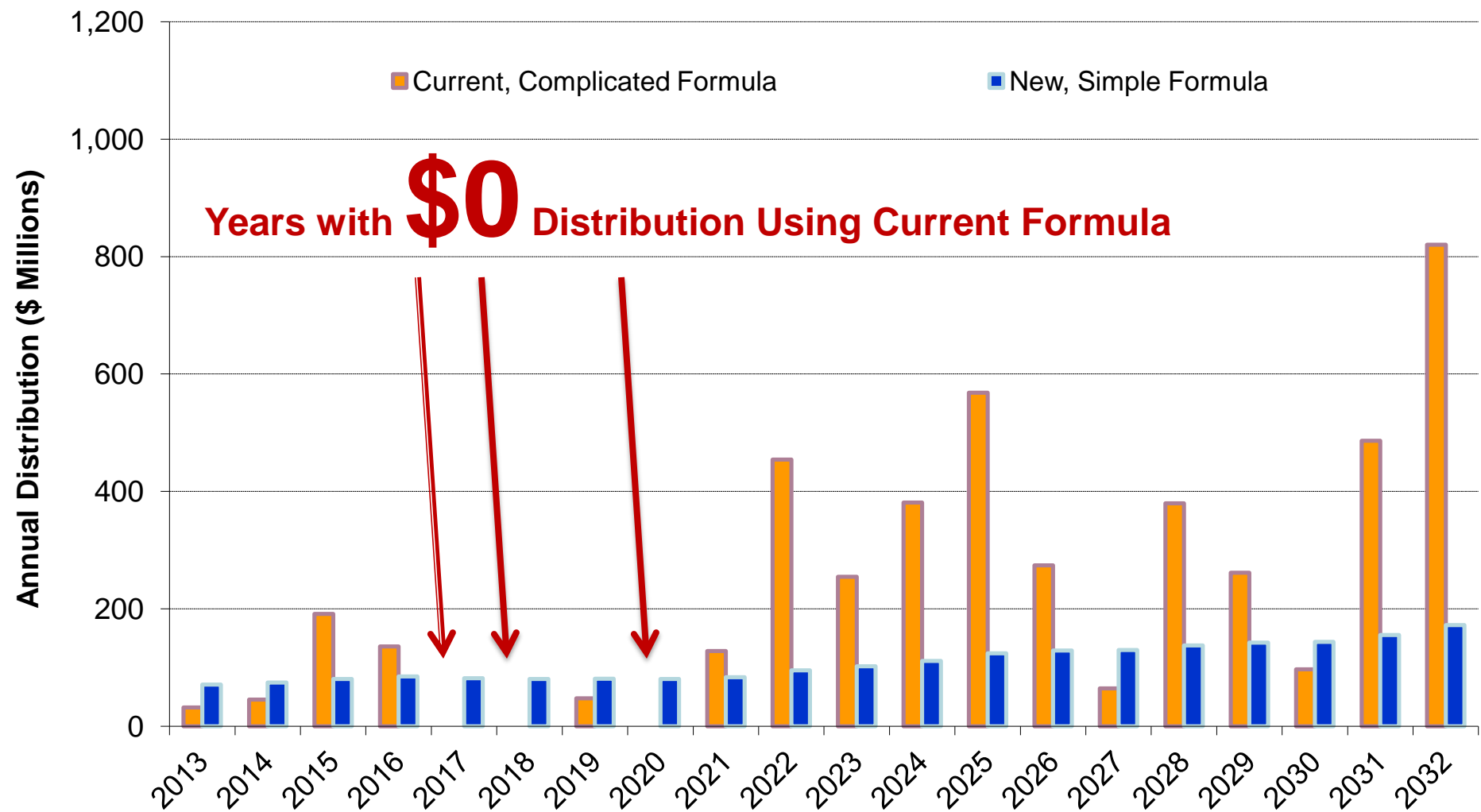
K-12 DISTRIBUTIONS



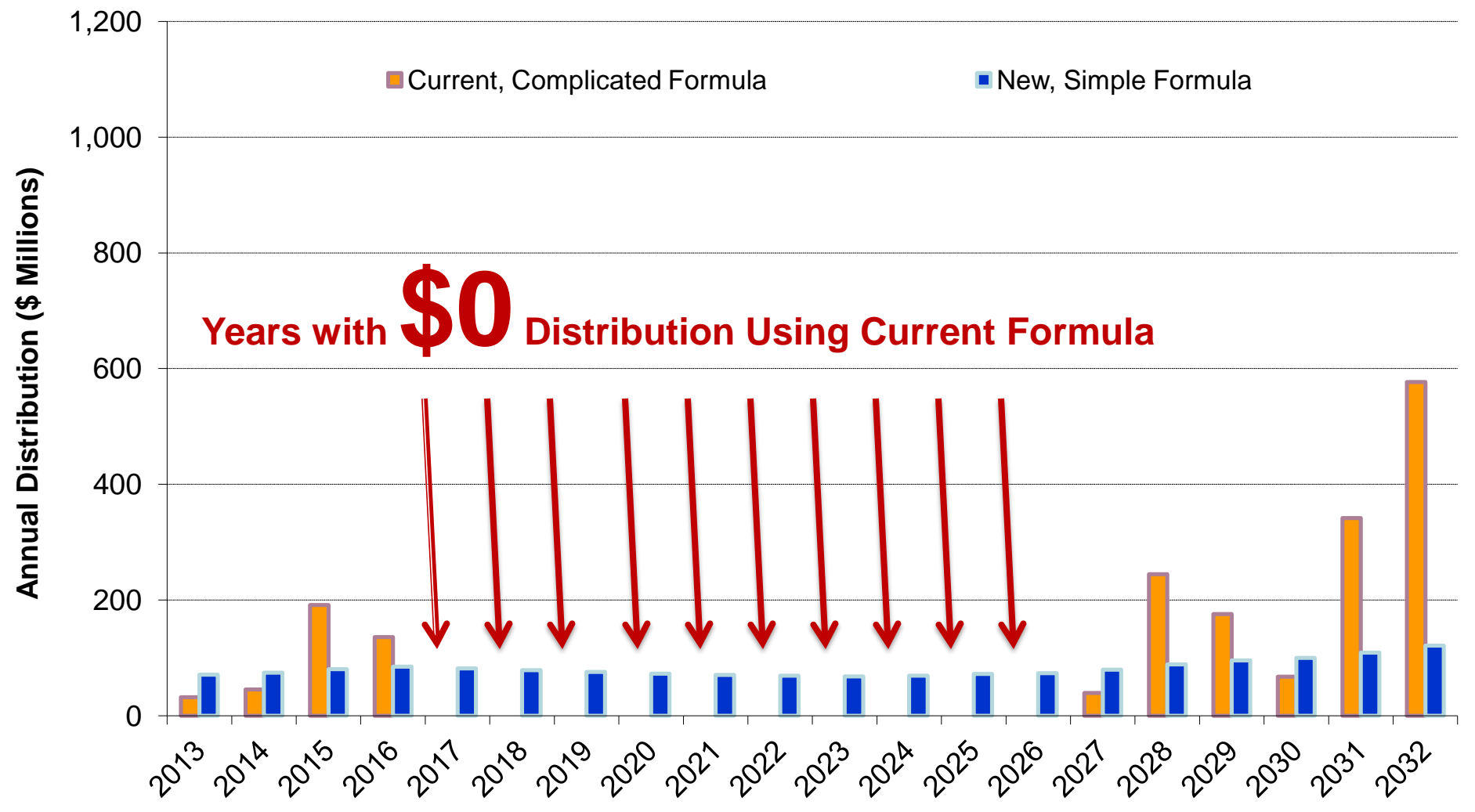
MODERATE MARKET SCENARIO



OPTIMISTIC MARKET SCENARIO



PESSIMISTIC MARKET SCENARIO





STATE CASH FLOW

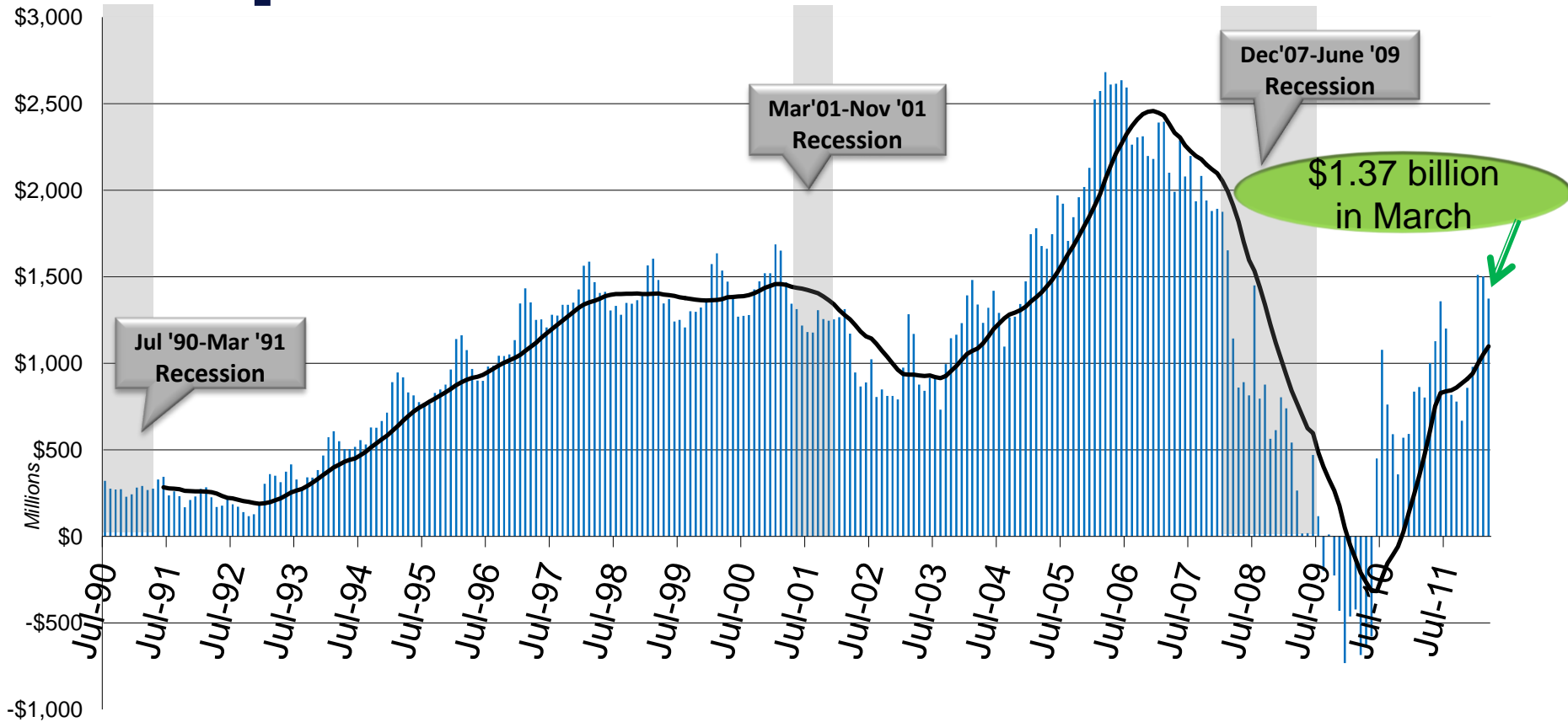
OFFICE OF THE ARIZONA STATE TREASURER



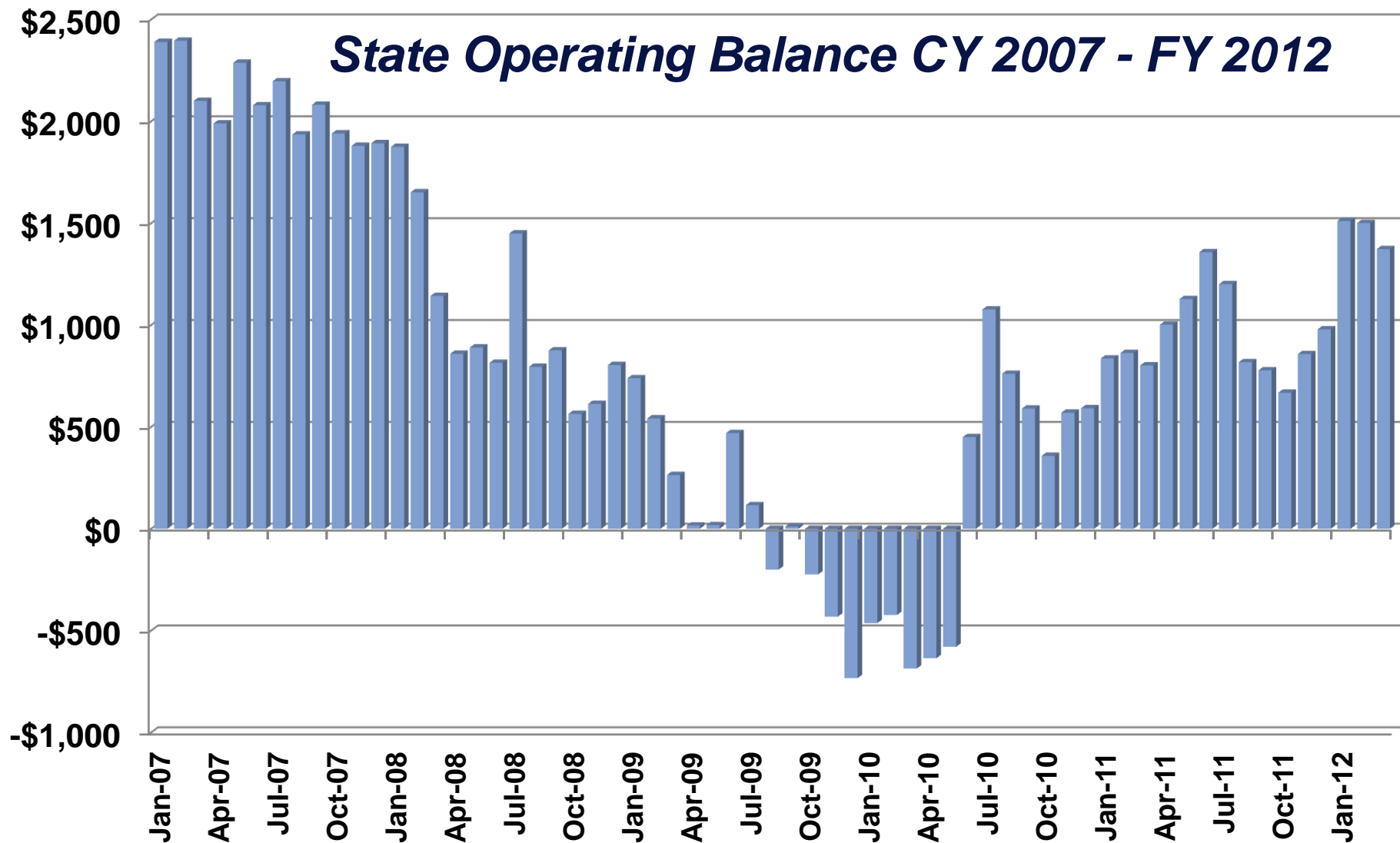
STATE CASH FLOW

TOTAL OPERATING ACCOUNT AVERAGE MONTHLY BALANCE

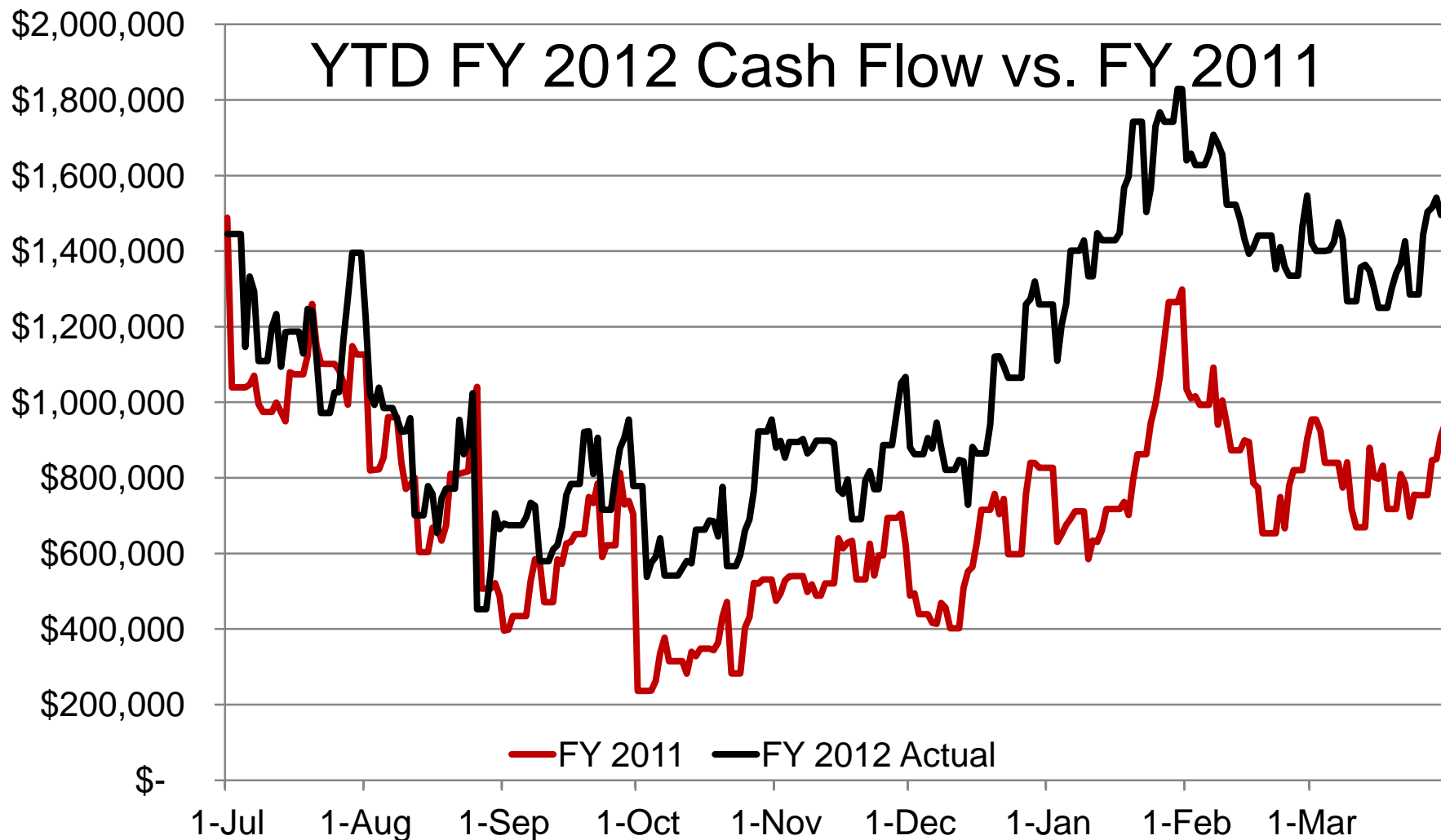
Up 50% in First 9 months YOY



STATE CASH FLOW



STATE CASH FLOW





Guest Presentation:

Richard Stavneak

Staff Director of the
Arizona Joint Legislative Budget Committee

OFFICE OF THE ARIZONA STATE TREASURER



State Treasurer's Quarterly Meeting

Revenue and Budget Update

April 26, 2012

JLBC

Revenue Overview

Key Economic Measures

- Current Arizona Status

Withholding Growth 3 Month Average Compared to Prior Year	2.6%
Retail Sales Tax Growth 3 Month Average Compared to Prior Year	5.1%
Pending Maricopa Foreclosures	17,800
Arizona Single Family Permits	11,400
Arizona Underwater Mortgages	48%

Arizona Forecasters Are Optimistic Compared to Other Western States

Blue Chip Forecast - % Personal Income Growth

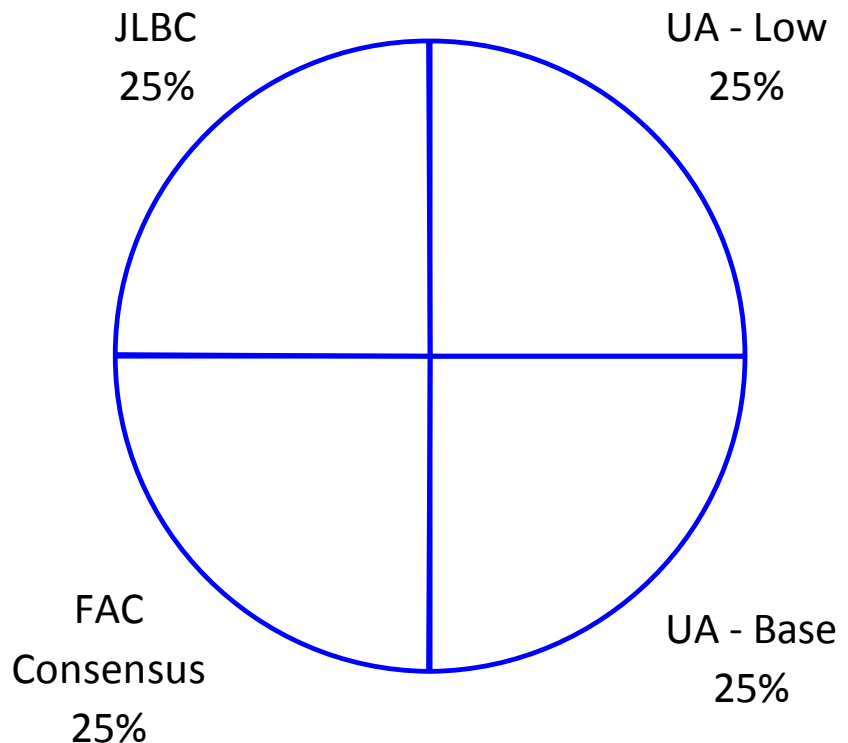
<u>CY 2012</u>		<u>CY 2013</u>	
Texas	5.1%	Arizona	5.8%
Arizona	4.9%	Utah	5.8%
Utah	4.8%	Texas	5.4%
Washington	4.5%	Washington	5.2%
Wyoming	4.5%	Colorado	4.7%
Colorado	4.4%	Oregon	4.4%
Oregon	4.4%	California	4.1%
California	4.0%	Idaho	3.8%
New Mexico	3.3%	Nevada	3.2%
Idaho	2.8%	New Mexico	3.4%
Nevada	2.4%	Wyoming	N/A

Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

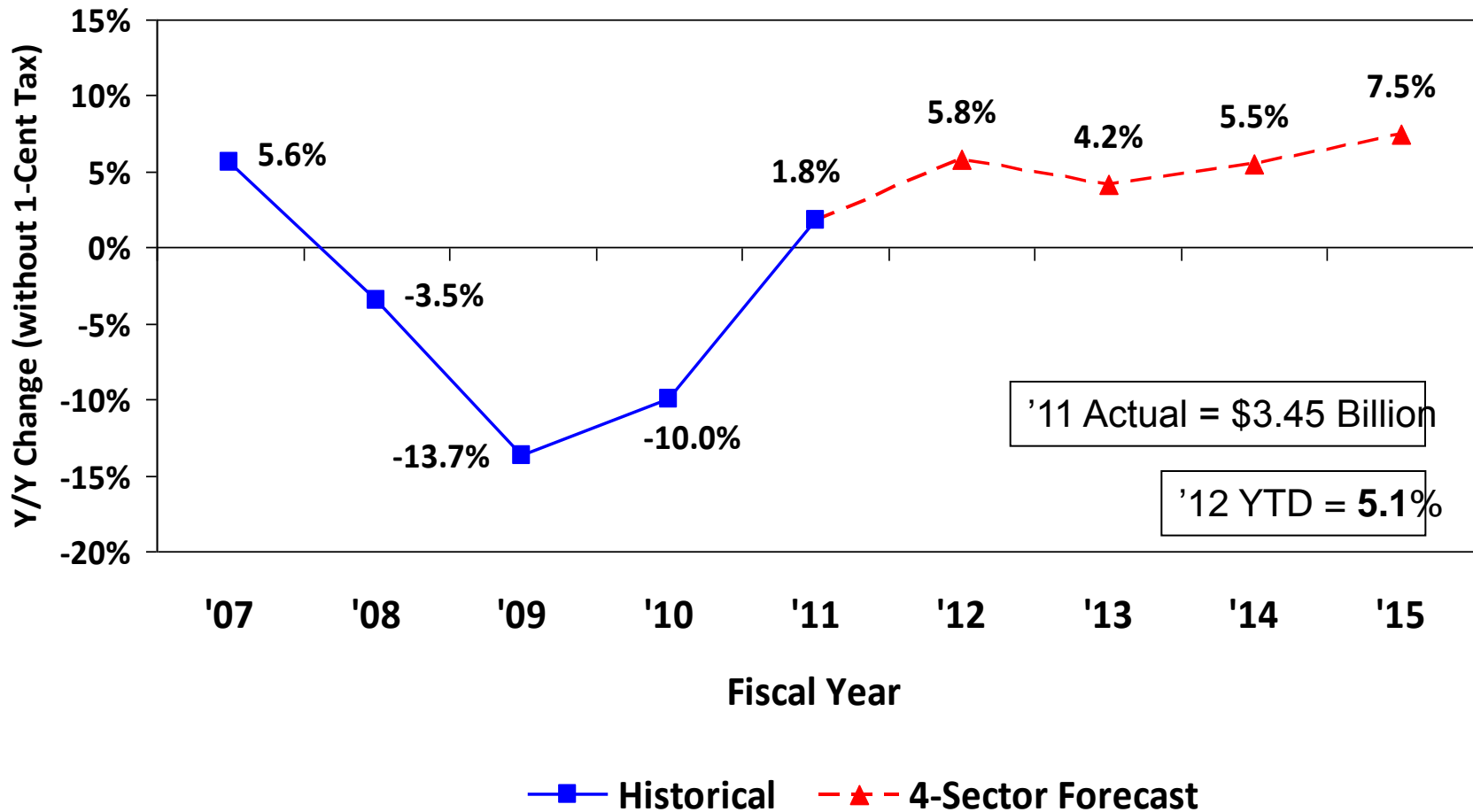
- ☐ FAC average
- ☐ UofA model – base
- ☐ UofA model – low
- ☐ JLBC Staff forecast
- ☐ Remaining revenues (10% of total) are staff forecast



* Includes Big 3 categories of sales tax, individual income and corporate income taxes

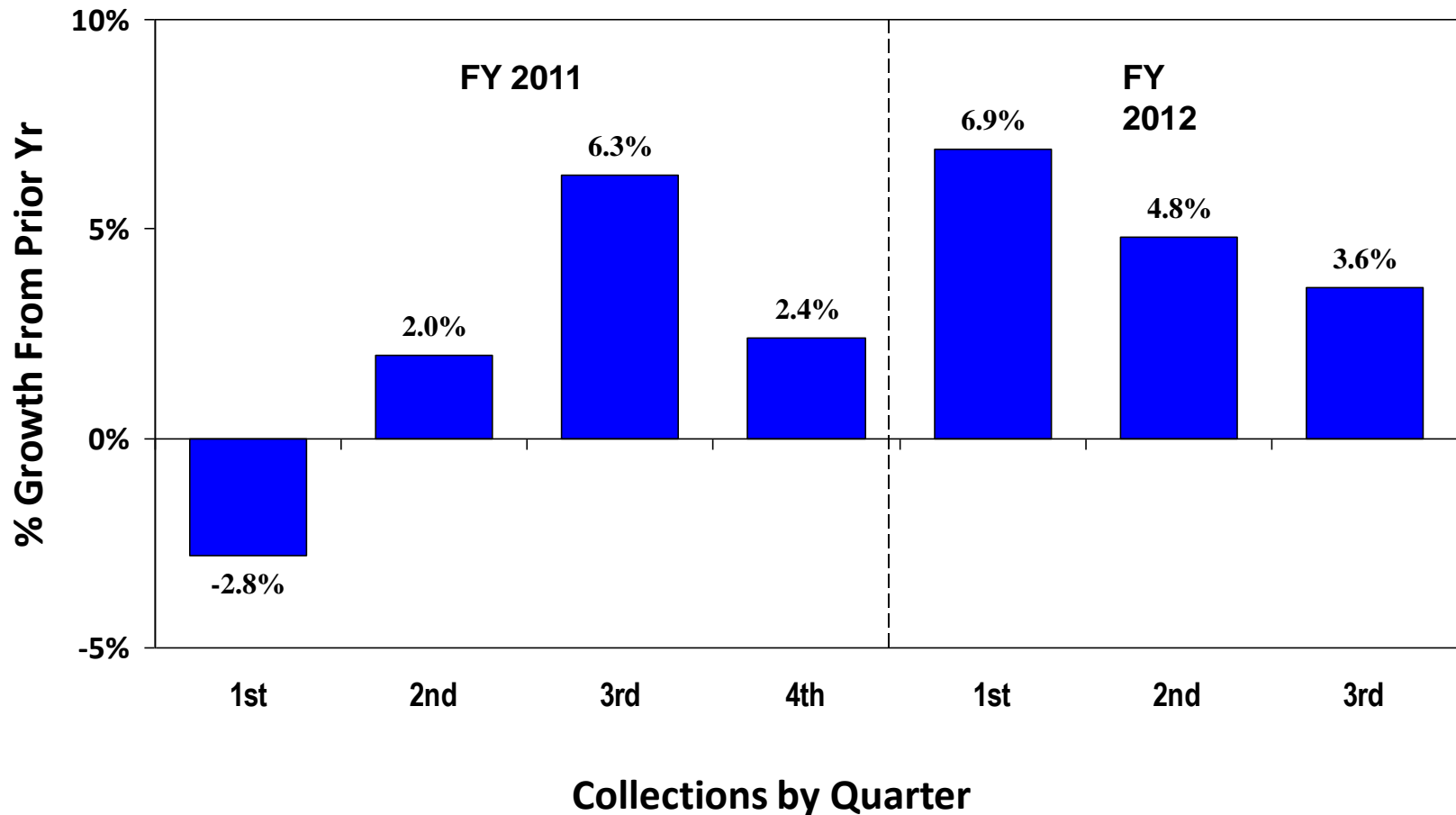
Sales Tax

- The Consensus Forecasts Growth of 5.8% in FY '12 and 4.2% in FY '13



Sales Tax Growth Rate Has Slowed Throughout Year

- Comparison to FY '11 Helps Explain FY '12 Path

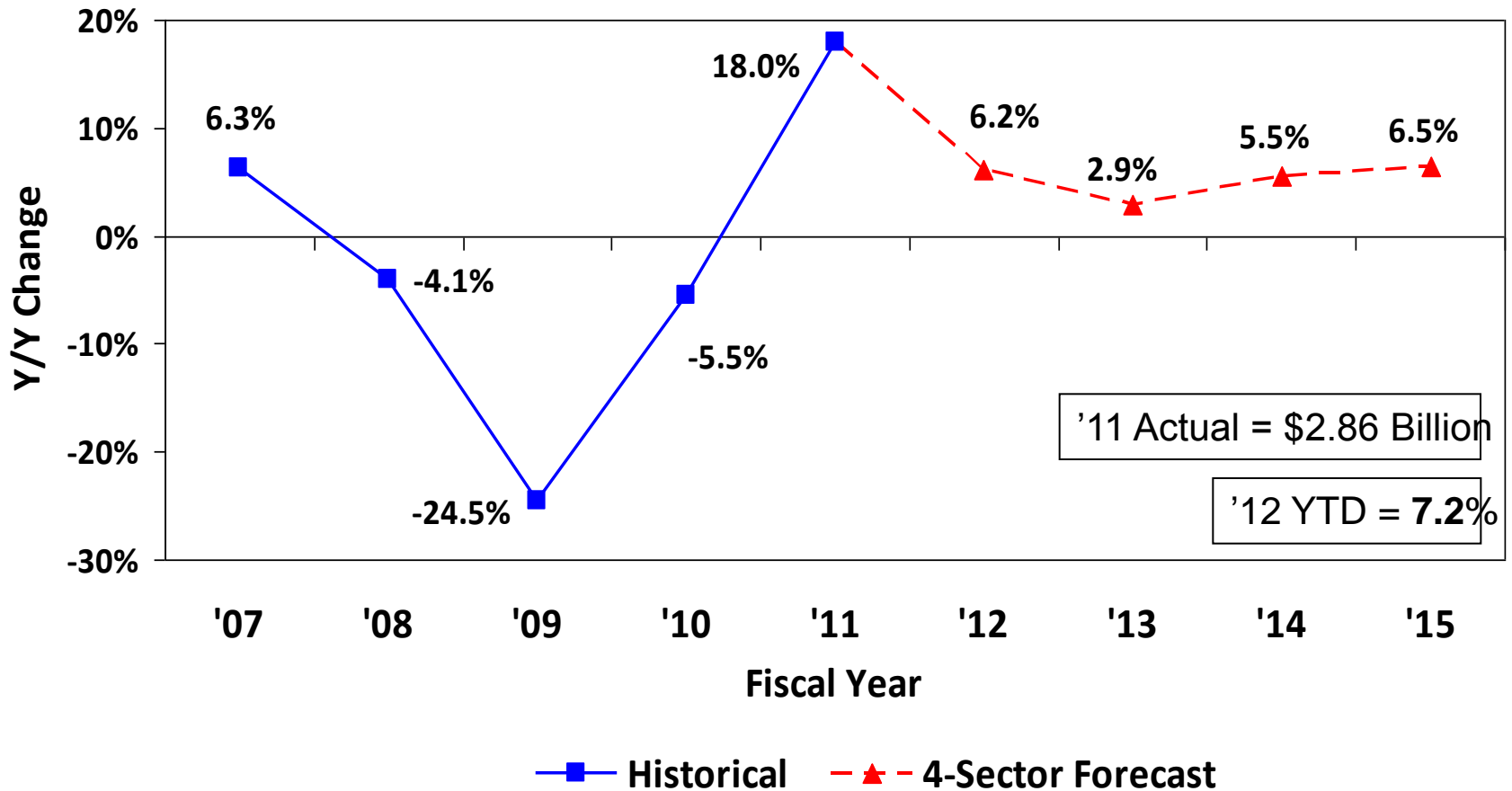


June 2013 TPT Estimated Payment

- ❑ Businesses with an annual sales tax liability above a certain threshold are required make a single estimated advance payment in June of each year
- ❑ Legislature lowered liability threshold for estimated payment from \$1 million to \$100,000 for FY '10 thru FY '12
- ❑ The reduced liability threshold generated a one-time revenue gain of \$48 million in FY '10
- ❑ When threshold reverts to \$1 million in FY '13, state will incur an estimated one-time revenue loss of \$(52) million

Individual Income Tax

- The Consensus Forecasts Growth of 6.2% in FY '12
Dropping to 2.9% in FY '13



Percent Change in Base Revenue Excluding
Tax Law and One-Time Changes

Components of Individual Income Tax Growth

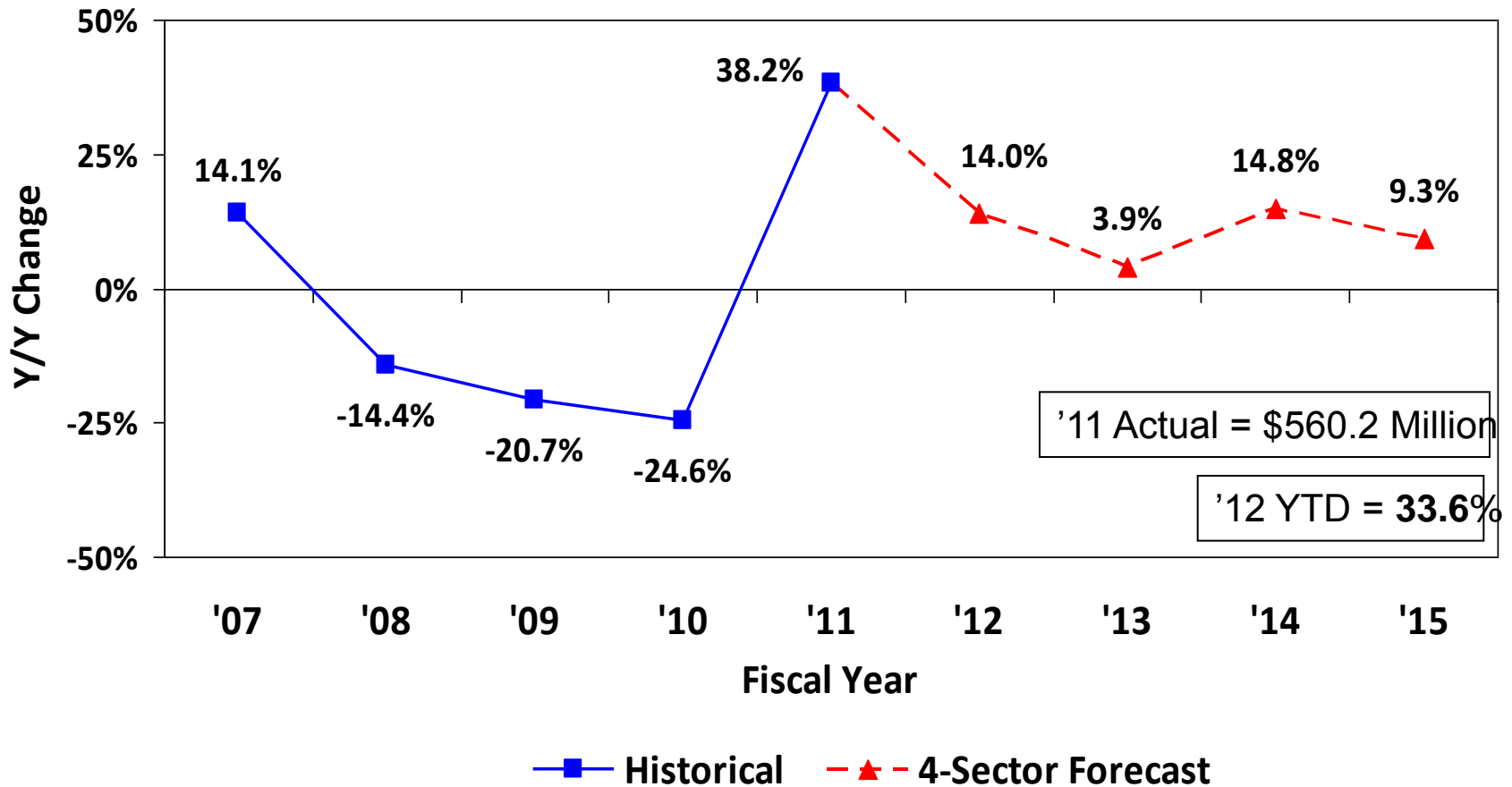
- First Three Quarters of FY '12

Withholding	3.1%
Payments	29.5%
<u>Refunds</u>	<u>4.5%</u>
Net	7.2%

- ❑ Growth appears to be in line with job and wage growth
- ❑ Payment increase overstated due to large one-time payment in January – absent this payment, growth would be 12.3%
- ❑ Refunds appear to be on track for first increase since FY '09

Corporate Income Tax

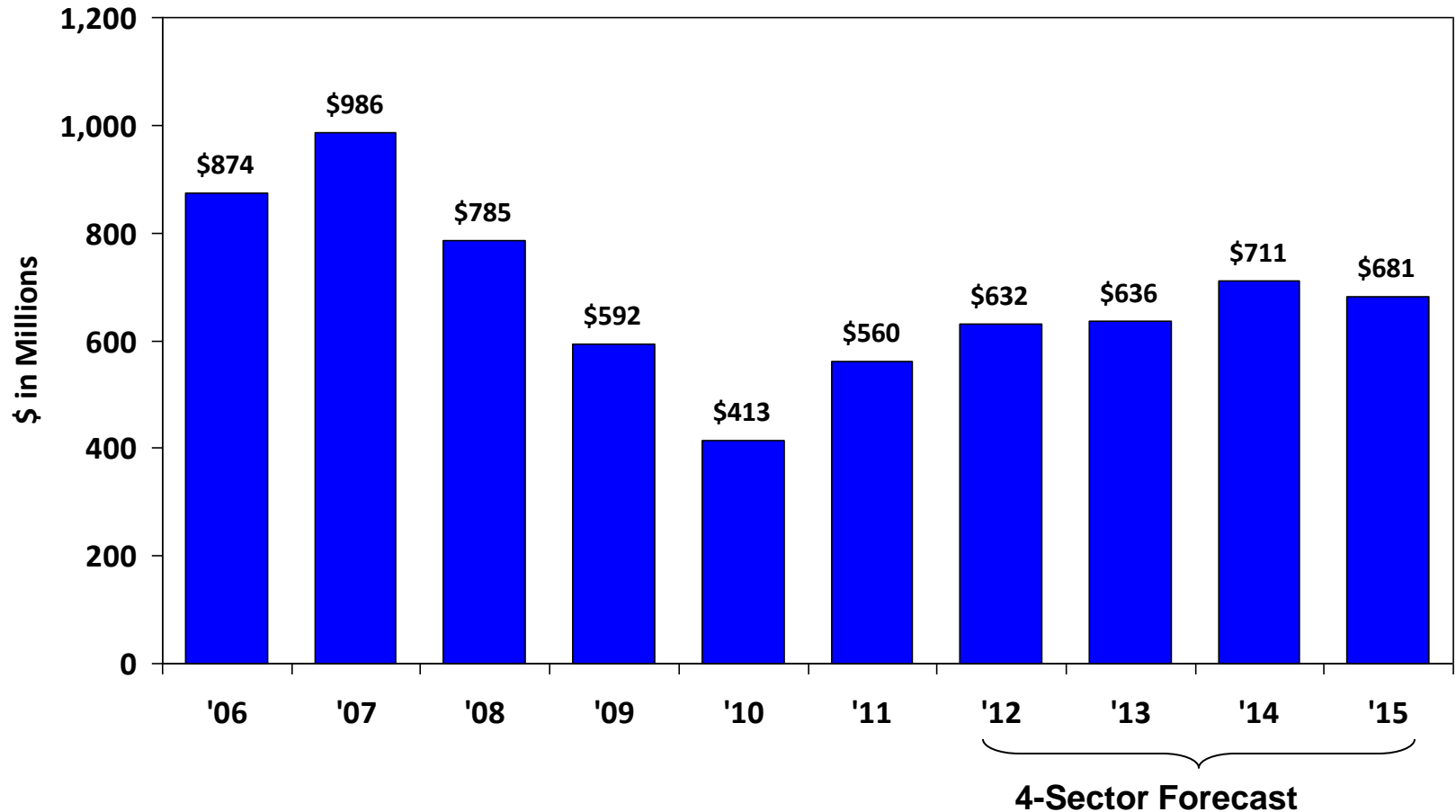
- The Consensus Forecasts Growth of 14.0% in FY '12
Dropping to 3.9% in FY '13



Percent Change in Base Revenue Excluding
Tax Law and One-Time Changes

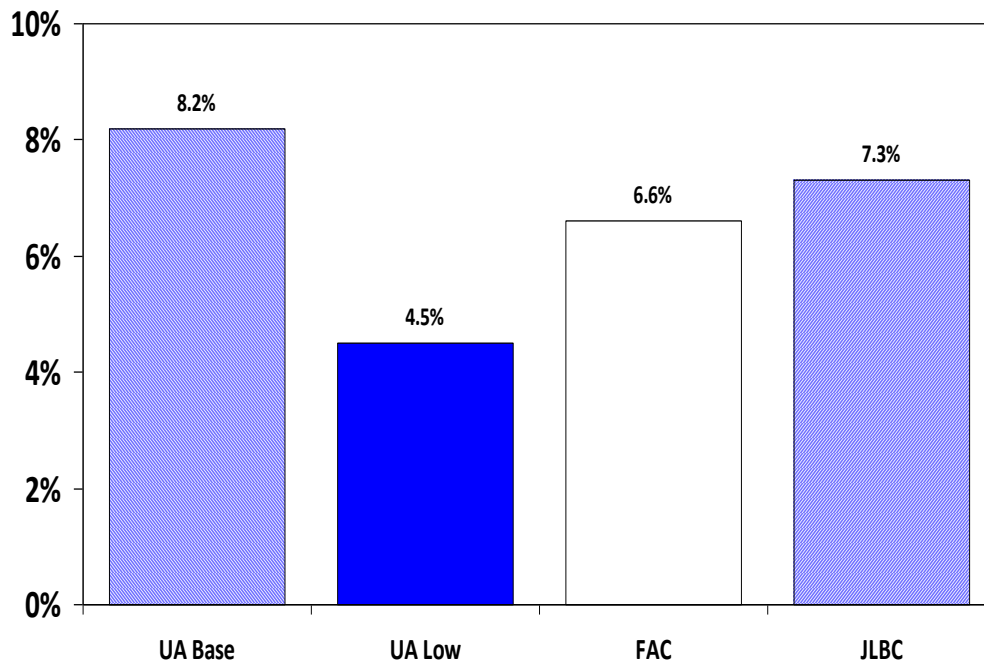
Corporate Income Tax

- Forecast Remains Substantially Below FY '07 High Point



Total dollar collections include enacted tax law changes and one-time adjustments.

Consensus Predicts Base Growth Rate of 5.6% in FY '12 *



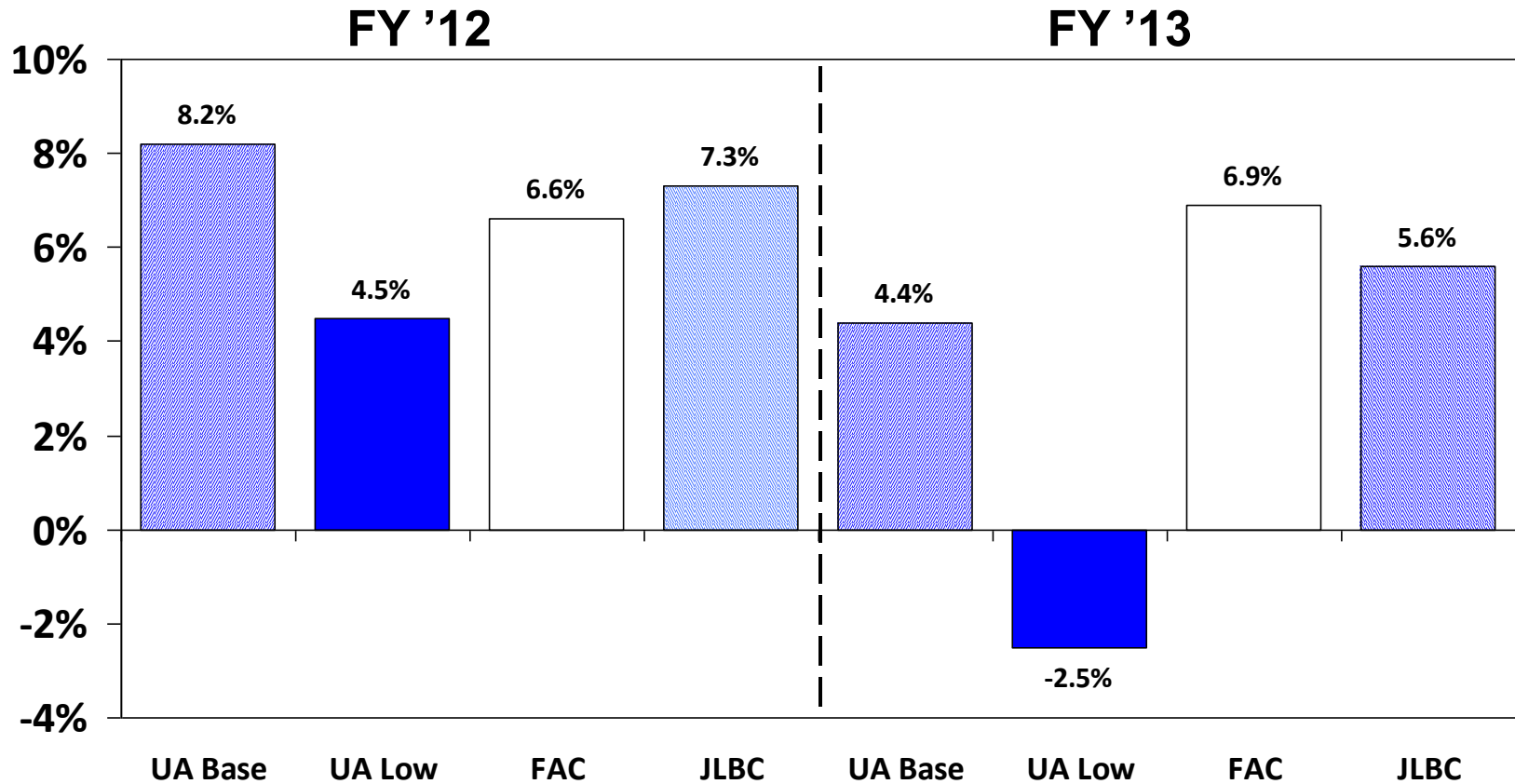
□ FY '12 YTD collections:

- 6.7% greater than FY '11 collections
- \$17 million or 0.3% over the January Baseline forecast

Details in Appendix A

* Weighted Big 3 average growth prior to 1-Cent sales tax is 6.6% in FY '12 . After adjusting for small tax categories, the base growth rate is 5.6% in FY '12.

Consensus Predicts Base Growth Rate Declining from 5.6% in FY '12 to 3.4% in FY '13*

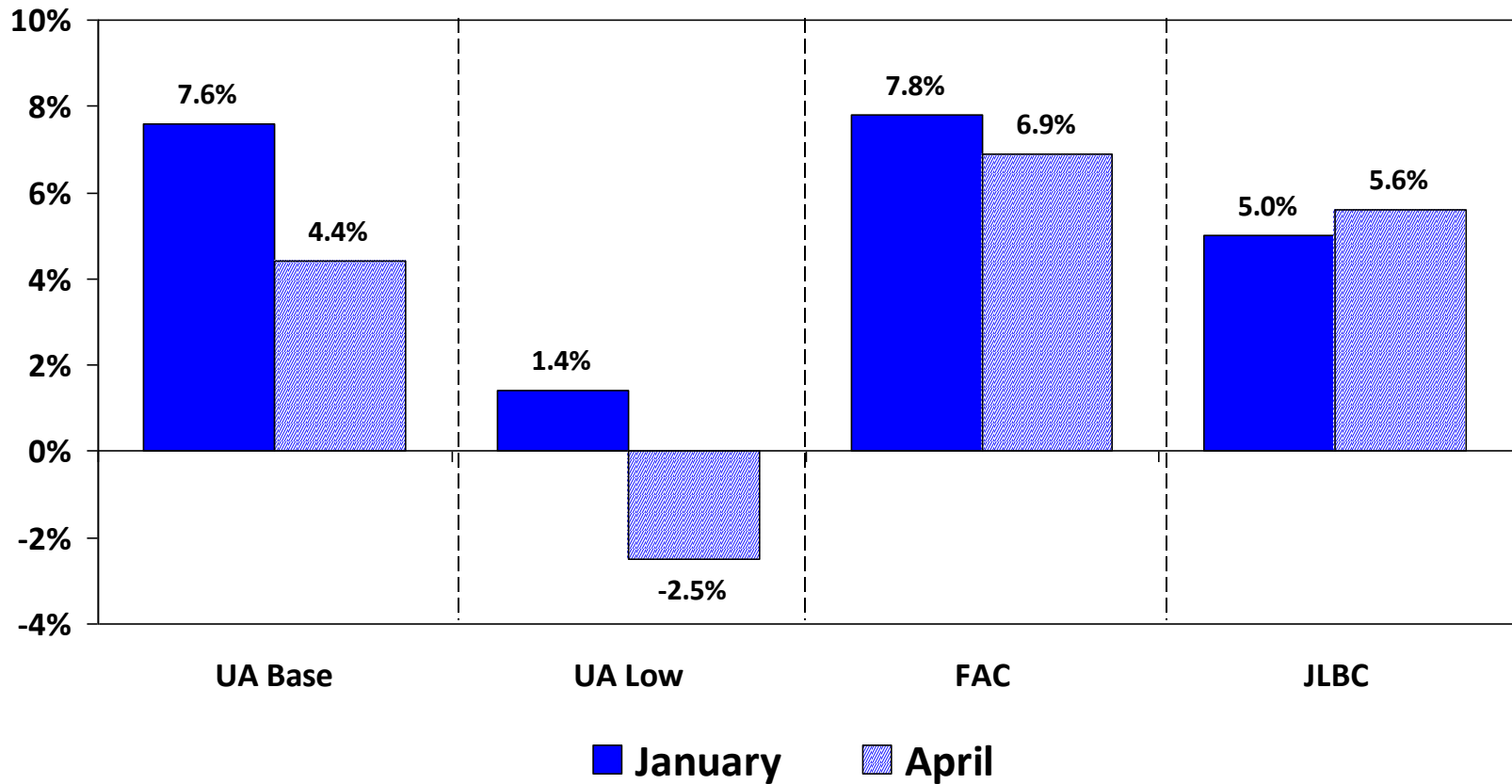


Details in Appendix A

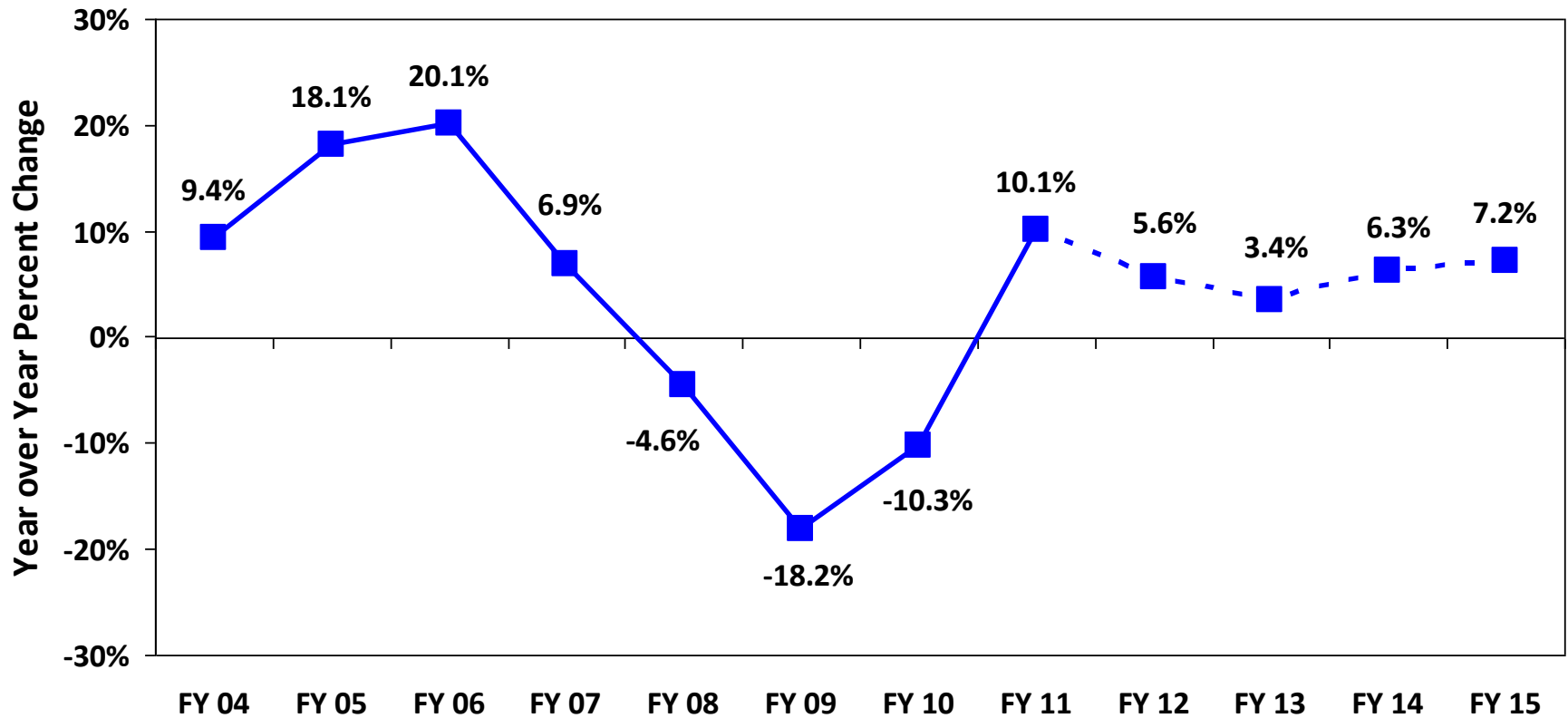
* Weighted Big 3 average growth prior to 1-Cent sales tax is 6.6% in FY '12 and 3.6% in FY '13. After adjusting for small tax categories, the base growth rate is 5.6% in FY '12 and 3.4% in FY '13.

FY '13 4-Sector Forecast

- April Components Compared to January



Consensus Forecasts Steadily Rising Revenue Growth Rate Through FY '15



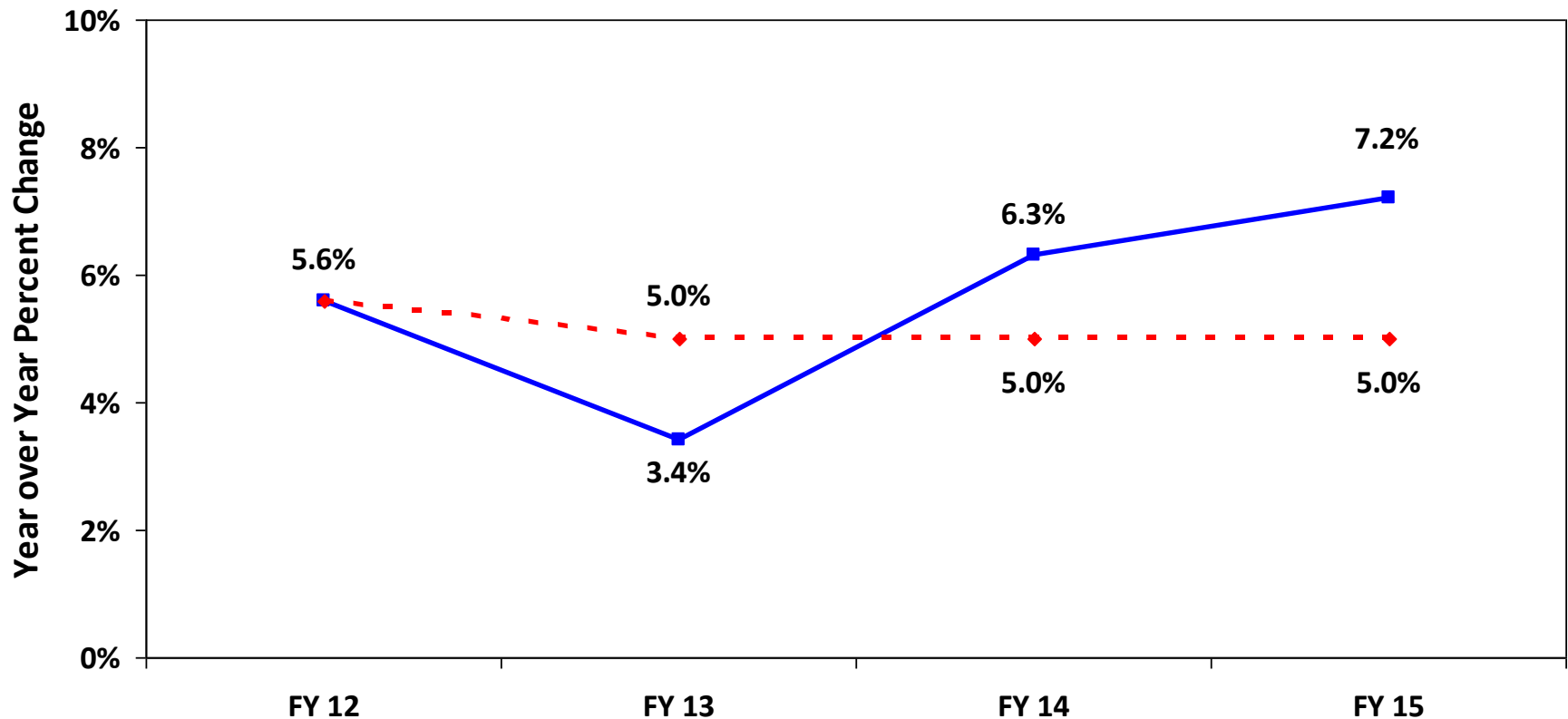
Percent Change in Base revenues excluding balance forward, tax law changes, one-time revenues, and urban revenue sharing

Two Potential Issues With 4-Sector

- 1) 3.4% FY '13 projection reflects slower average growth than many general economic projections
- 2) 4-Sector growth rates accelerate in out-years
– budget forecasts usually become more cautious in the long run

An Alternate Scenario Assumes 5% Annual Growth through FY '15

- In the FY '12-'15 Cycle, Produces Total Revenue Comparable to 4-Sector



Percent Change in Base revenues excluding balance forward, tax law changes, one-time revenues, and urban revenue sharing

Comparison of Revenue Forecasts

- Base General Fund Percentage Revenue Growth

	<u>FY '12</u>	<u>FY '13</u>	<u>FY '14</u>	<u>FY '15</u>
January 4-Sector	5.3%	5.1%	6.9%	7.9%
April 4-Sector	5.6%	3.4%	6.3%	7.2%
April – Alternate	5.6%	5.0%	5.0%	5.0%
Executive <u>1</u> /	5.3%	6.5%	7.3%	6.4%

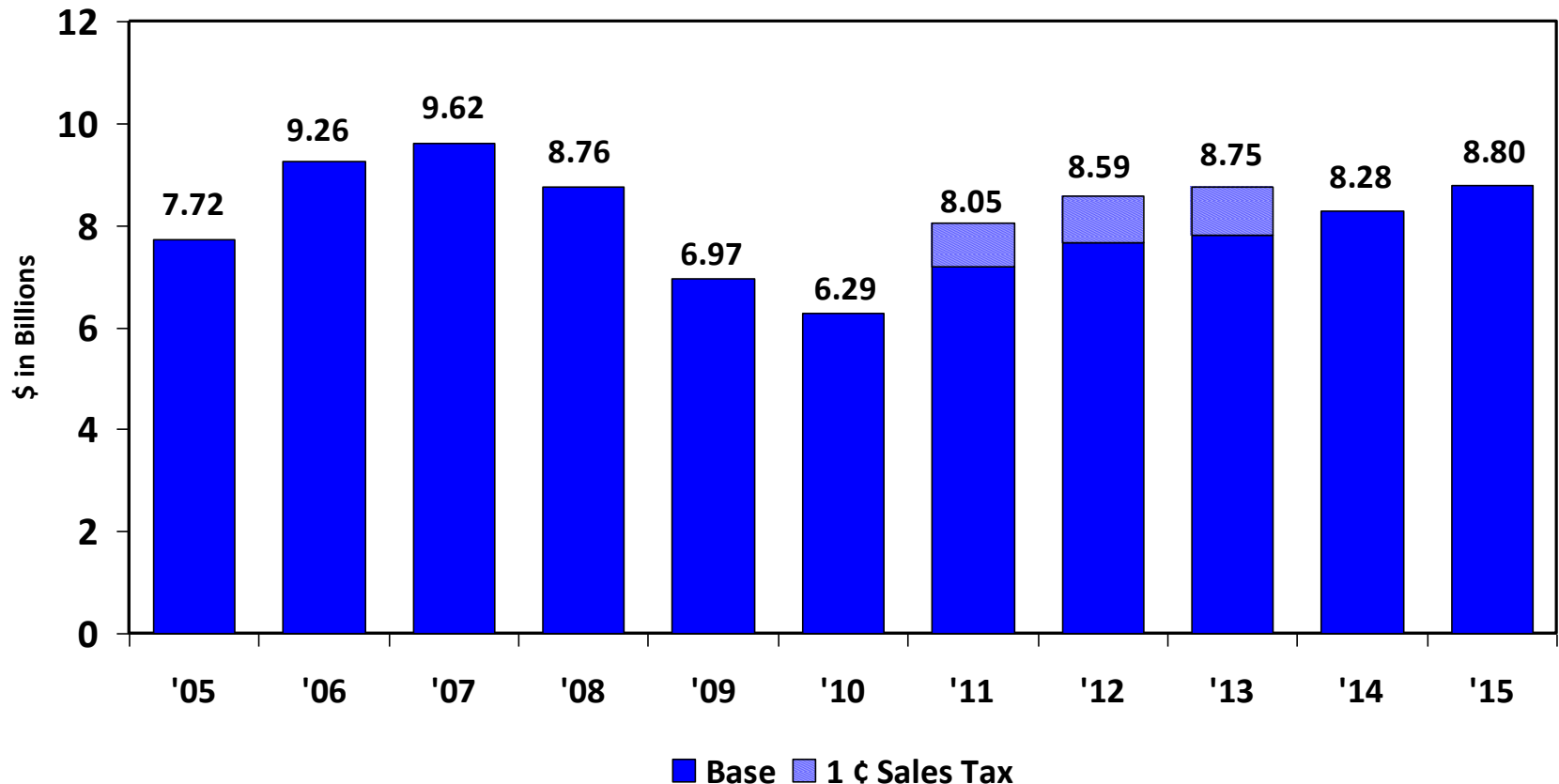
-The April estimate has slow FY '13 growth, followed by accelerating economy in FY '14 and FY '15.

-- The FY '13 4-sector may be too low and out-year budgets are not usually based on accelerating growth.

-- The Alternative scenario produces a comparable amount of revenue to the April 4-sector.

1/ Stated relative to January FAC prior year estimate for comparability.

Consensus Forecast Remains Below FY '07 High



Excludes balance forward and other one-time revenues. Includes tax law changes and Urban Revenue Sharing.

Risks to the Economic Forecasts

- ❑ Impact of international economy uncertain
 - Difficult to predict outcome, leading some national forecasters to place recession risk at 20%
- ❑ Cannot predict natural disasters or political events ahead of time
 - Iran and Israel
 - Gasoline prices
- ❑ Effect of future federal tax and spending decisions

Spending Overview

Baseline Revision in Long Term Spending Estimates

- Relative to Appropriation Committee Estimates

- ❑ Federal Health Care cost has been re-estimated from \$421 M to \$210 M in FY '15
 - Reflects further analysis of Executive's \$421 M estimate
 - Assumes childless adult enrollment returns to pre-freeze levels plus 50% participation of currently eligible but not participating individuals
- ❑ FY '15 New School construction costs projections have declined from \$150 M to \$56 M
 - Reflects reduction in SFB's projection of new school openings
- ❑ See Attachment B for more details

FY '12 – '15 Projections

- ❑ The projections include the April 4-sector revenue estimates and the spending plan approved by the Appropriations Committee in February
- ❑ The ending balance estimates are affected by whether the prior year budget has a surplus or shortfall

	<u>'12</u>	<u>'13</u>	<u>'14</u>	<u>'15</u>
Revenues	\$8.7 B	\$8.5 B	\$8.3 B	\$8.8 B
Spending	\$8.5 B	\$8.5 B	\$8.7 B	\$9.2 B
Balance (W/O Carryforward)	\$187 M	\$ 80 M	\$(402) M	\$(410) M
Balance (W/Carryforward)	\$187 M	\$267 M	\$(134) M	\$(545) M

Change in Ending Balance Projections

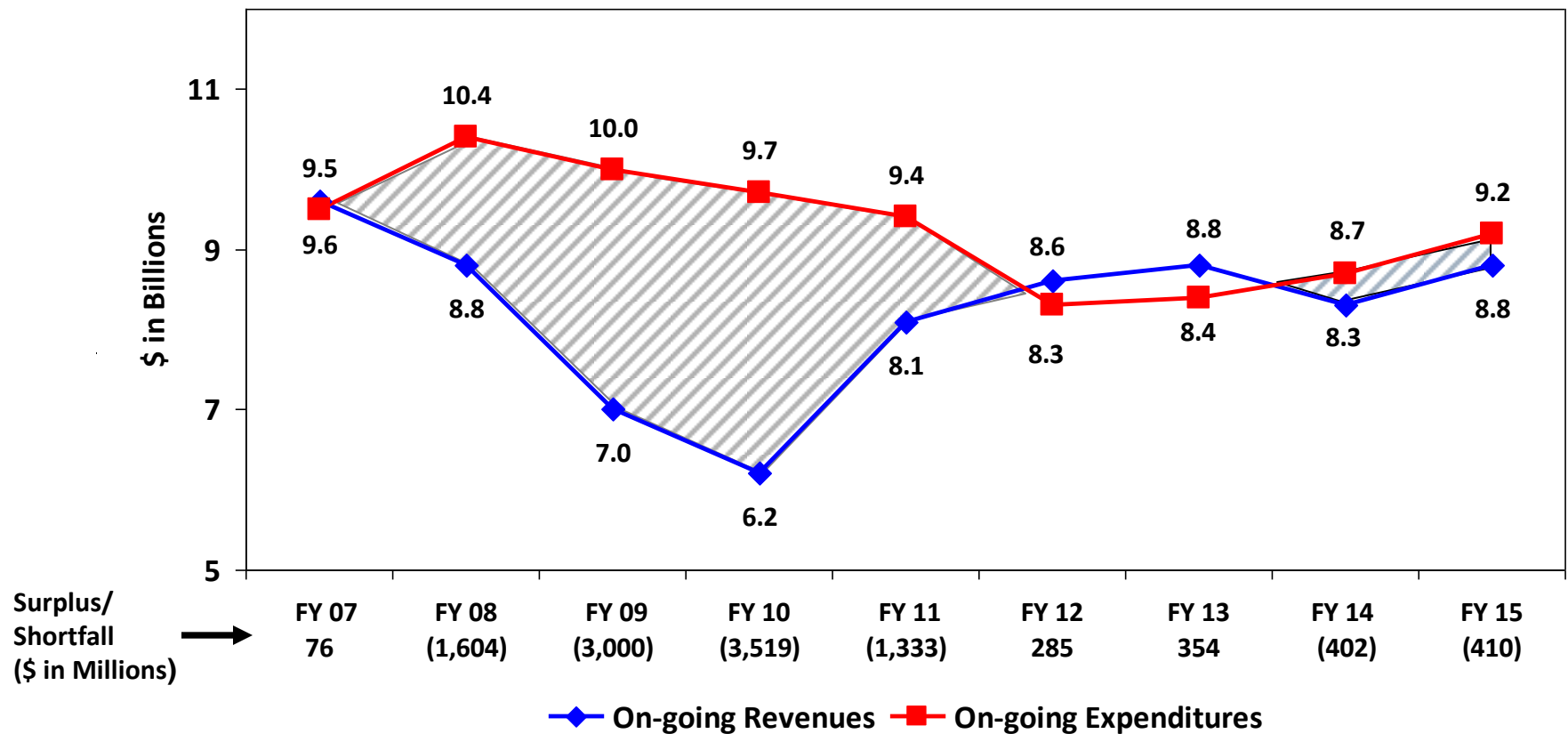
- The lower April 4-sector revenue estimates would lower the projected FY '13 ending balance and increase the FY '15 shortfall

	<u>'12</u>	<u>'13</u>	<u>'14</u>	<u>'15</u>
Balance with January Revenue	\$137 M	\$303 M	\$ 69 M	\$(380) M
Balance with April Revenue	\$187 M	\$267 M	\$(134) M	\$(545) M

Includes carryforward from prior year

Structural Balance – April Revenue Estimate vs Appropriation Committee Spending

- Strong FY '13 Position Helps State



Counts 1 ¢ TPT as on-going in FY '11 – FY '13

The Caveats

- ❑ New permanent initiatives would reduce the FY '13 balance and increase the FY '14 and FY '15 shortfalls
- ❑ A 3-Year budget forecast is inherently unreliable
 - A 2% error could change revenues by \$500 M in the 3rd year
- ❑ Serious federal deficit reduction could increase state costs
- ❑ Pending Supreme Court decision on federal health care and other state “budget” lawsuits could affect long term costs

Appendix A: April 2012 4-Sector Forecast

	FY 2012	FY 2013	FY 2014	FY 2015
Sales Tax				
JLBC Forecast	5.7%	5.2%	6.8%	7.2%
UA – Low	5.2%	0.2%	3.7%	8.1%
UA – Base	7.0%	4.5%	6.3%	8.7%
FAC	5.4%	6.7%	5.1%	6.1%
Average:	5.8%	4.2%	5.5%	7.5%
Individual Income Tax				
JLBC Forecast	5.8%	6.4%	7.0%	7.0%
UA – Low	4.2%	-4.9%	3.9%	6.0%
UA – Base	9.6%	3.9%	5.6%	6.8%
FAC	5.1%	6.2%	5.2%	5.9%
Average:	6.2%	2.9%	5.5%	6.5%
Corporate Income Tax				
JLBC Forecast	25.0%	3.7%	4.8%	3.0%
UA – Low	1.2%	-7.4%	22.5%	15.9%
UA – Base	8.5%	6.8%	24.5%	13.5%
FAC	21.1%	11.0%	10.8%	6.0%
Average:	14.0%	3.9%	14.8%	9.3%
JLBC Weighted Average:	7.3%	5.6%	6.7%	6.8%
UA Low Weighted Average	4.5%	-2.5%	5.1%	7.9%
UA Base Weighted Average	8.2%	4.4%	7.5%	8.3%
FAC Weighted Average:	6.6%	6.9%	5.7%	6.0%
“Big-3” Weighted Average	6.6%	3.6%	6.3%	7.2%
Consensus Weighted Average:*	5.6%	3.4%	6.3%	7.2%
Adjusted Consensus Weighted Average:**	5.6%	2.9%	6.0%	6.0%
* Consensus Big-3 Categories adjusted for small revenue categories				
** Consensus Weighted Average adjusted for tax law changes				

Appendix B: Summary of Baseline Spending Adjustments

The budget proposal heard in the House and Senate Appropriations Committees originally assumed an FY 2015 shortfall of \$(675) million. This shortfall estimate included \$421 million for costs associated with federal healthcare requirements and \$150 for School Facilities Board new construction costs.

Based on further analysis of these issues, the estimate of federal healthcare requirement costs has been reduced to \$210 million, while the SFB cost projection has been reduced to \$56 million.

The following summary provides further detail of these estimates.

AHCCCS

FY 14 Federal Health Care Projection - \$40M

- Program starts in January 2014.
- New enrollees include:
 - Newly eligible – Any person with income from 100 to 133% FPL.
 - Currently eligible – Any person with income from 0 to 100% FPL, who is not a childless adult. Publicity of federal health care is expected to encourage some of these already eligible people to enroll.
 - Previously eligible childless adults – An adult without children 18 years and younger who has income from 0 to 100% FPL.
- 165,000 new enrollees in Medicaid in FY 14 as a result of federal health care changes, about half of the total expected to ultimately enroll.
 - 40,000 (35%) of the newly eligible.
 - 65,000 (25%) of the currently eligible.
 - 60,000 (50%) of the previously eligible childless adults from 0 to 100%.

The federal government covers 100% of costs for the newly eligible, 65% for the currently eligible, and 82% for restored childless adults.

Appendix B (continued)

- A partially offsetting savings is realized from the enhanced federal match of 82% (up from 65%) for 120,000 still enrolled childless adults.
- Capitation rates increase 5% in FY 14.

FY 15 Federal Health Care Projection - \$210M

- First full year of implementation.
- The remaining portion of expected enrollees comes onto Medicaid, resulting in a total of 325,000 new enrollees from federal health care changes.
 - 75,000 (70%) of the newly eligible.
 - 135,000 (50%) of the currently eligible.
 - 115,000 (100%) of the previously eligible childless adults from 0 to 100% FPL.
- The federal match for previously eligible childless adults increases from 82 to 85% of costs.
- A partially offsetting savings is realized from the enhanced federal match of 85% for 120,000 still enrolled childless adults.
- Capitation rates increase 5% in FY 15.

School Facilities Board

FY 15 New School Construction Projection - \$56 M

- Estimate based on projects requested by the School Facilities Board in FY 2013 budget request.
- Eliminates projects which have been cancelled due to lower than expected enrollment forecasts.
- Cost estimate incorporates all new construction projects scheduled to open through FY 16. Assumes entire funding amount is appropriated in FY 15.

Tracking Arizona's Recovery

April 2012

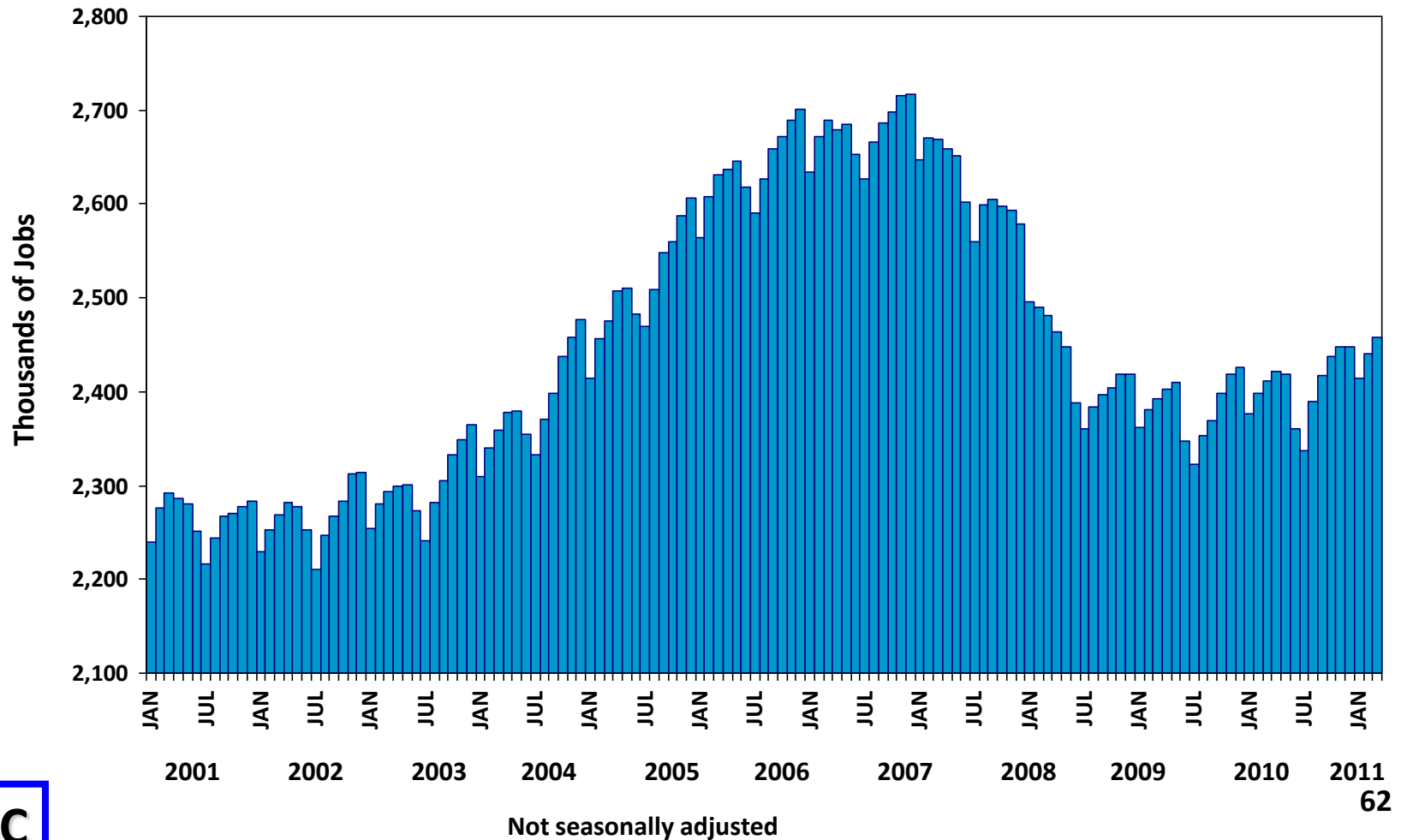
JLBC

Contents

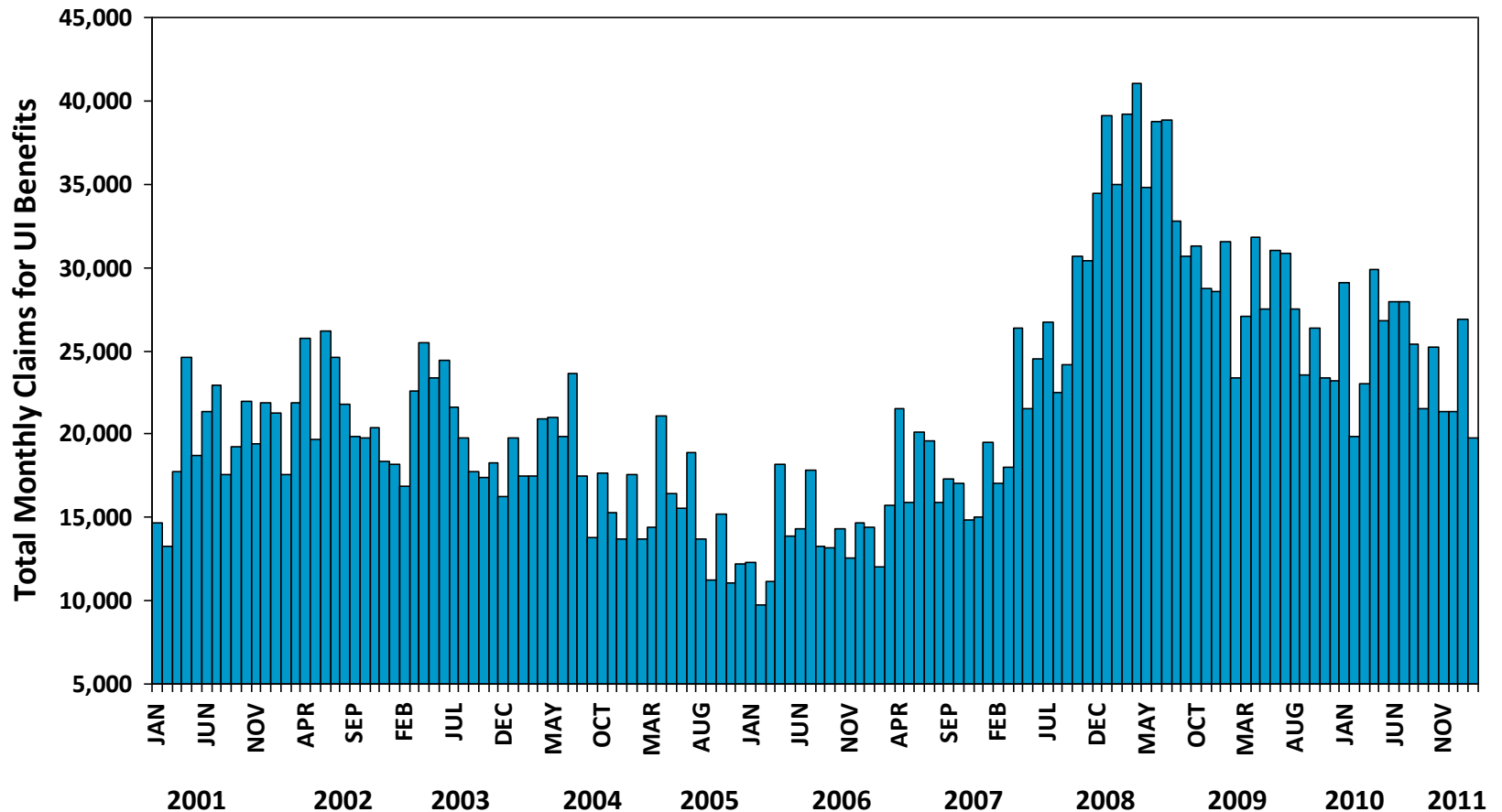
Slide:

- 3.....Total Non-Farm Employment
- 4.....Initial Claims for Unemployment Insurance
- 5.....State Sales Tax Collections – Retail Category
- 6.....State Sales Tax Collections – Contracting
Category
- 7.....Single Family Building Permits
- 8.....Maricopa County Pending Foreclosures
- 9.....Coincident Index

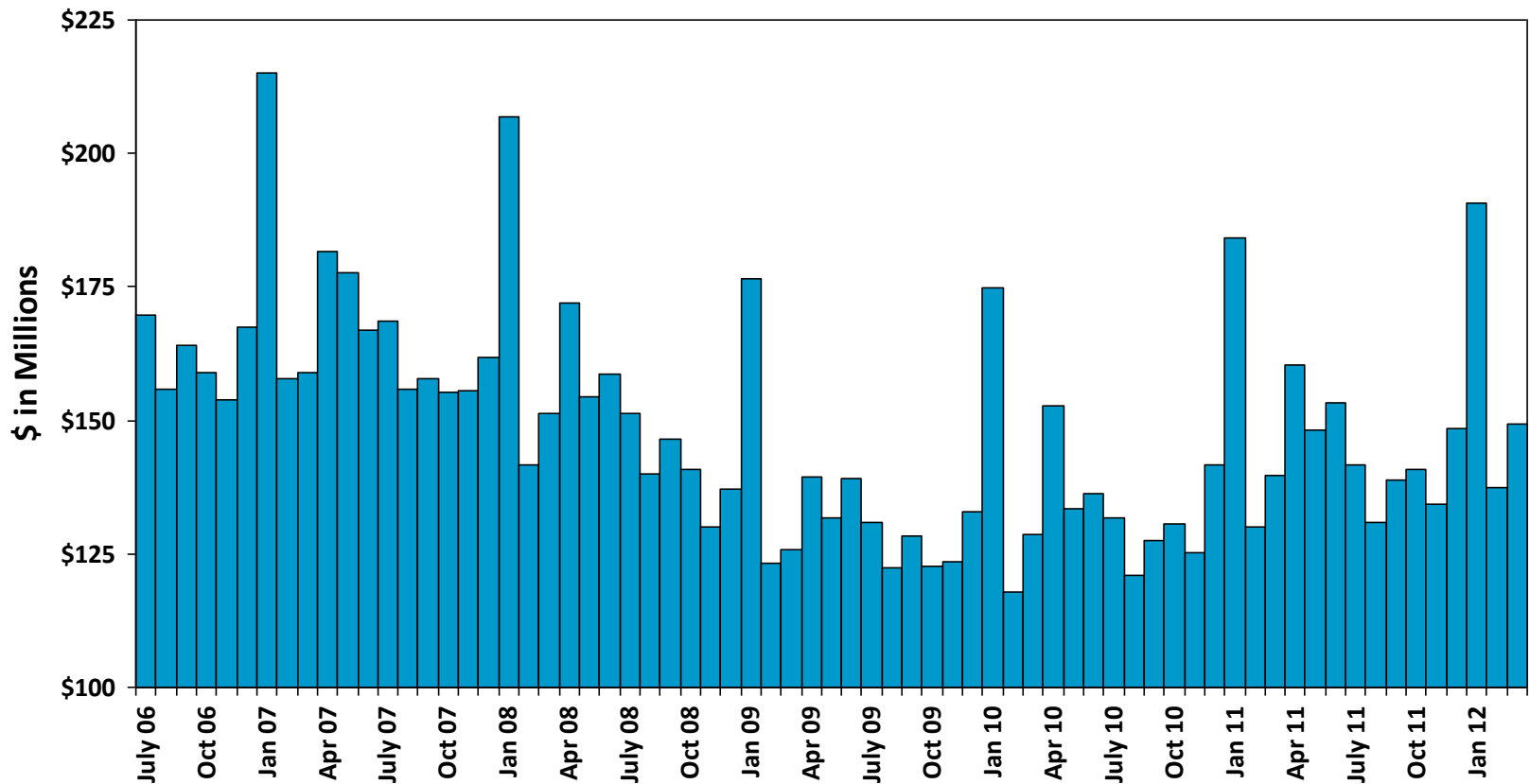
Total Non-Farm Employment



Initial Claims for Unemployment Insurance

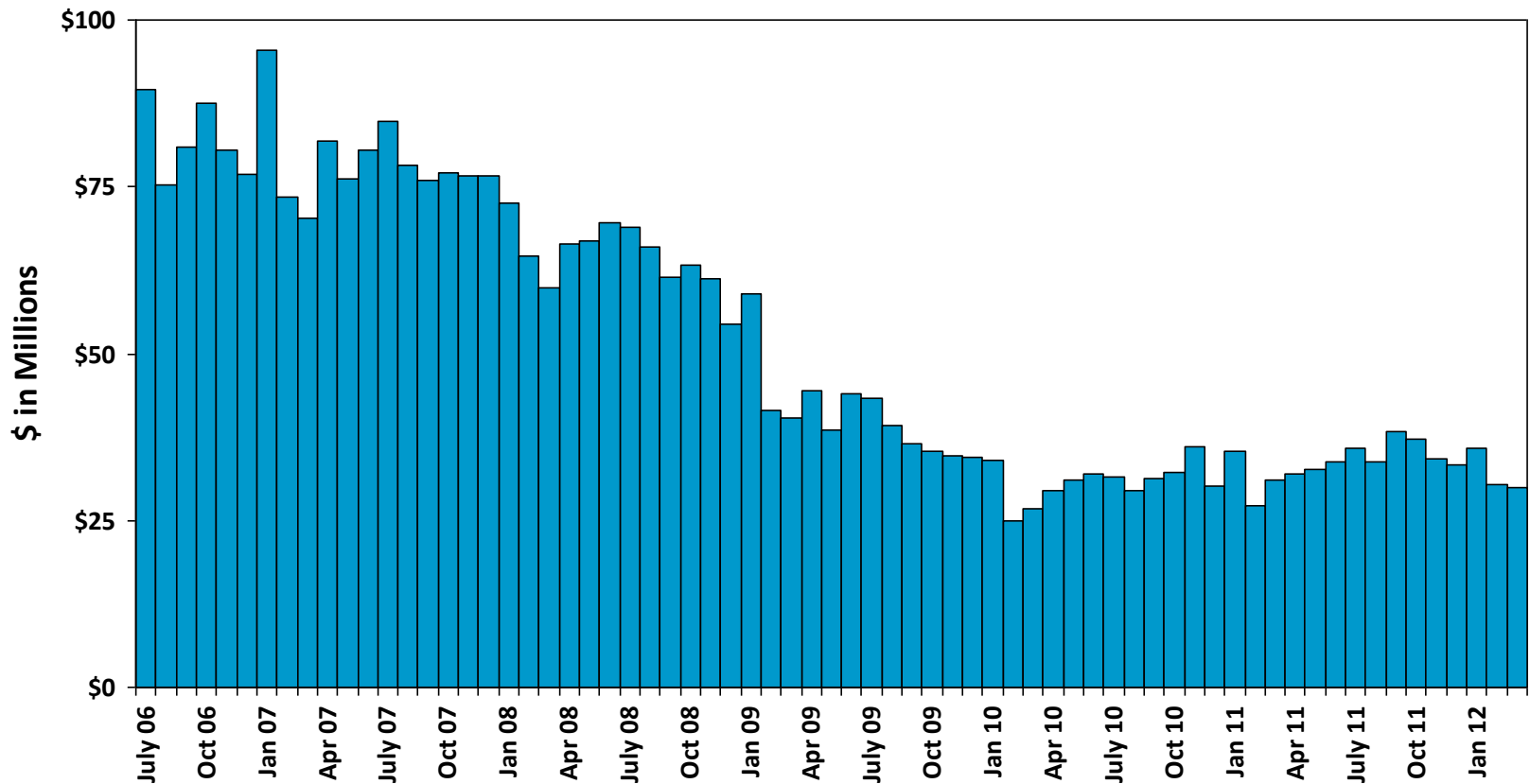


State Sales Tax Collections – Retail Category



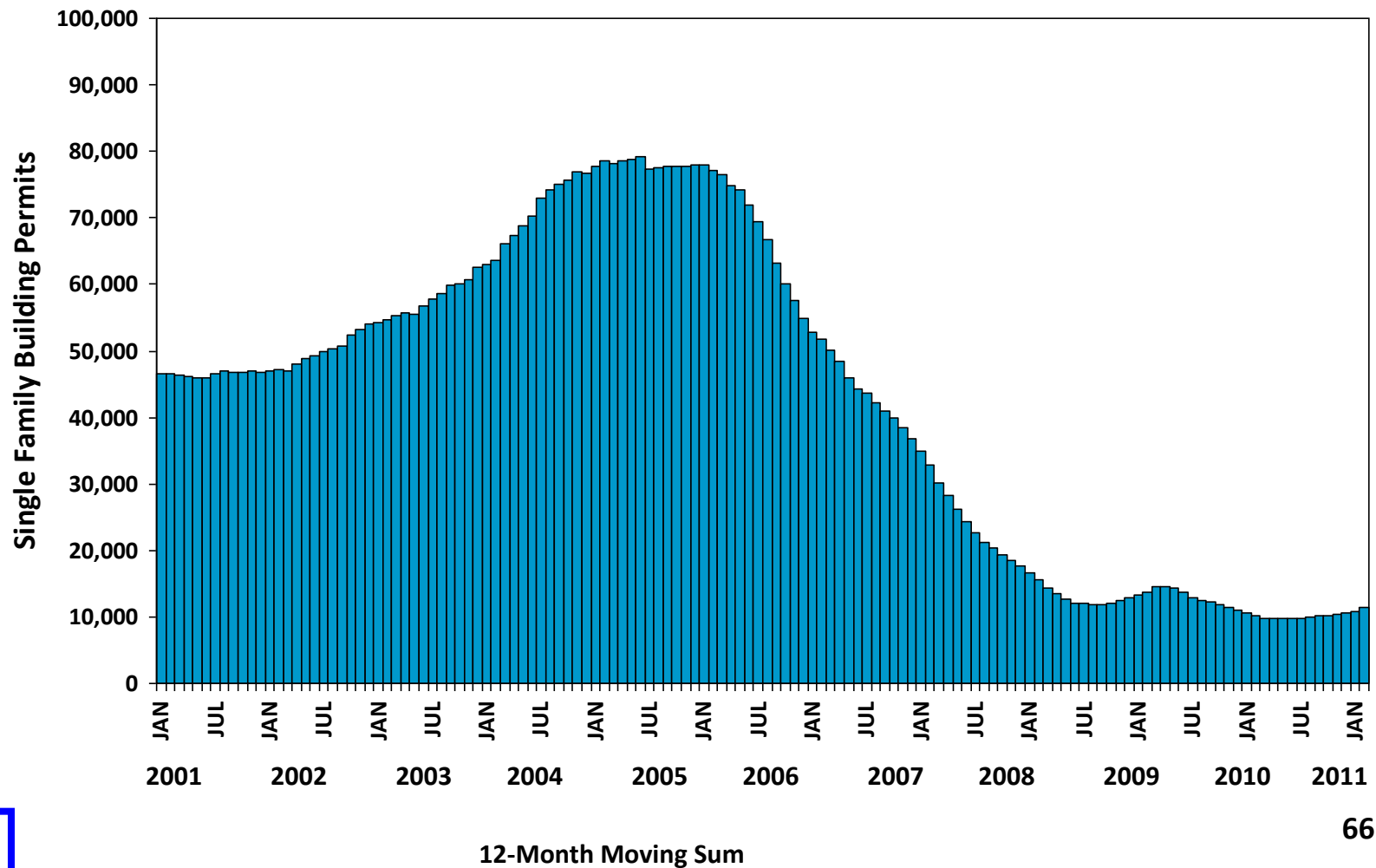
Excludes temporary 1 ¢ sales tax

State Sales Tax Collections – Contracting Category

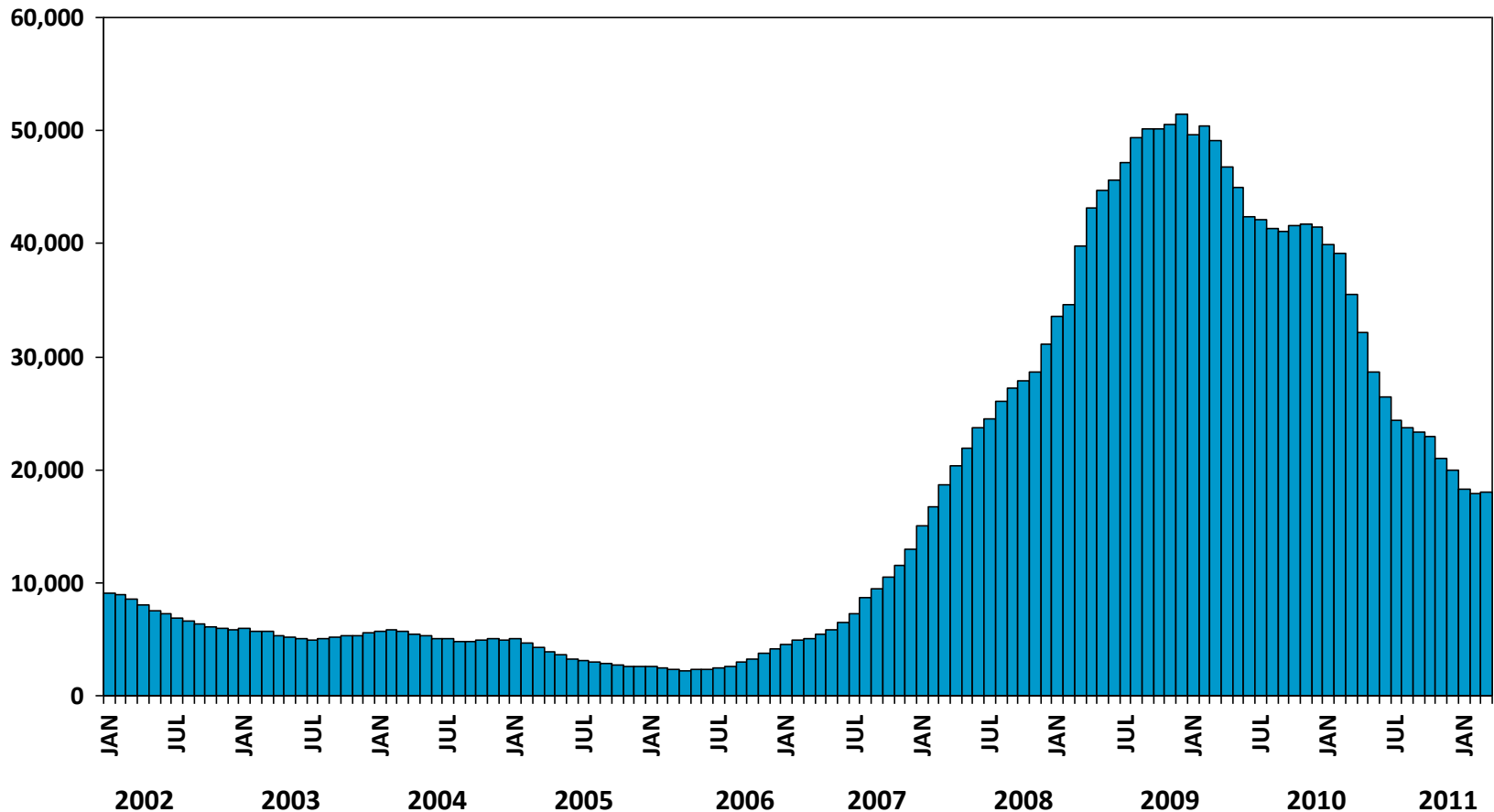


Excludes temporary 1 ¢ sales tax

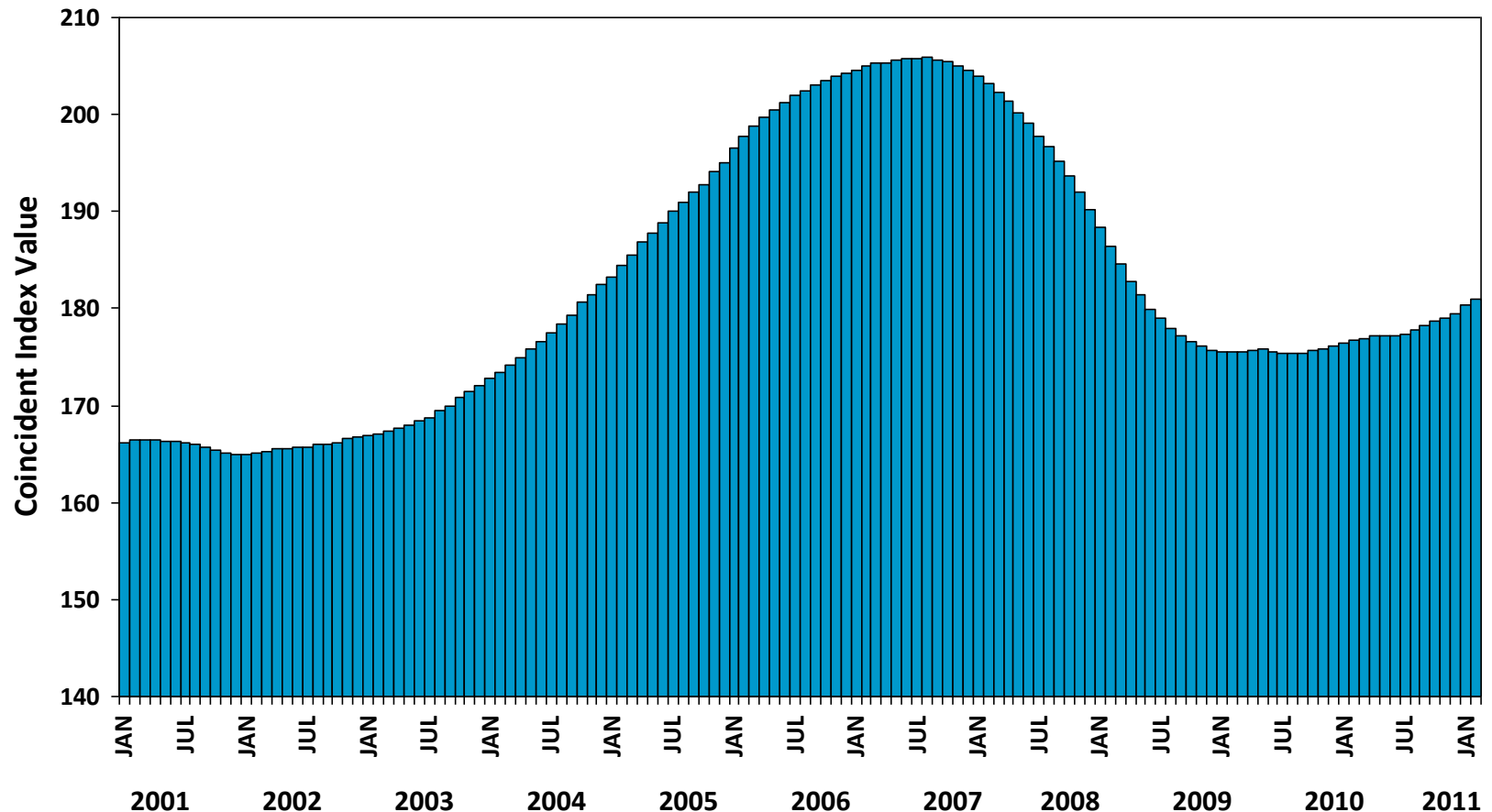
Single Family Building Permits



Maricopa County Pending Foreclosures



Economic Activity Index





QUESTIONS?

OFFICE OF THE ARIZONA STATE TREASURER

